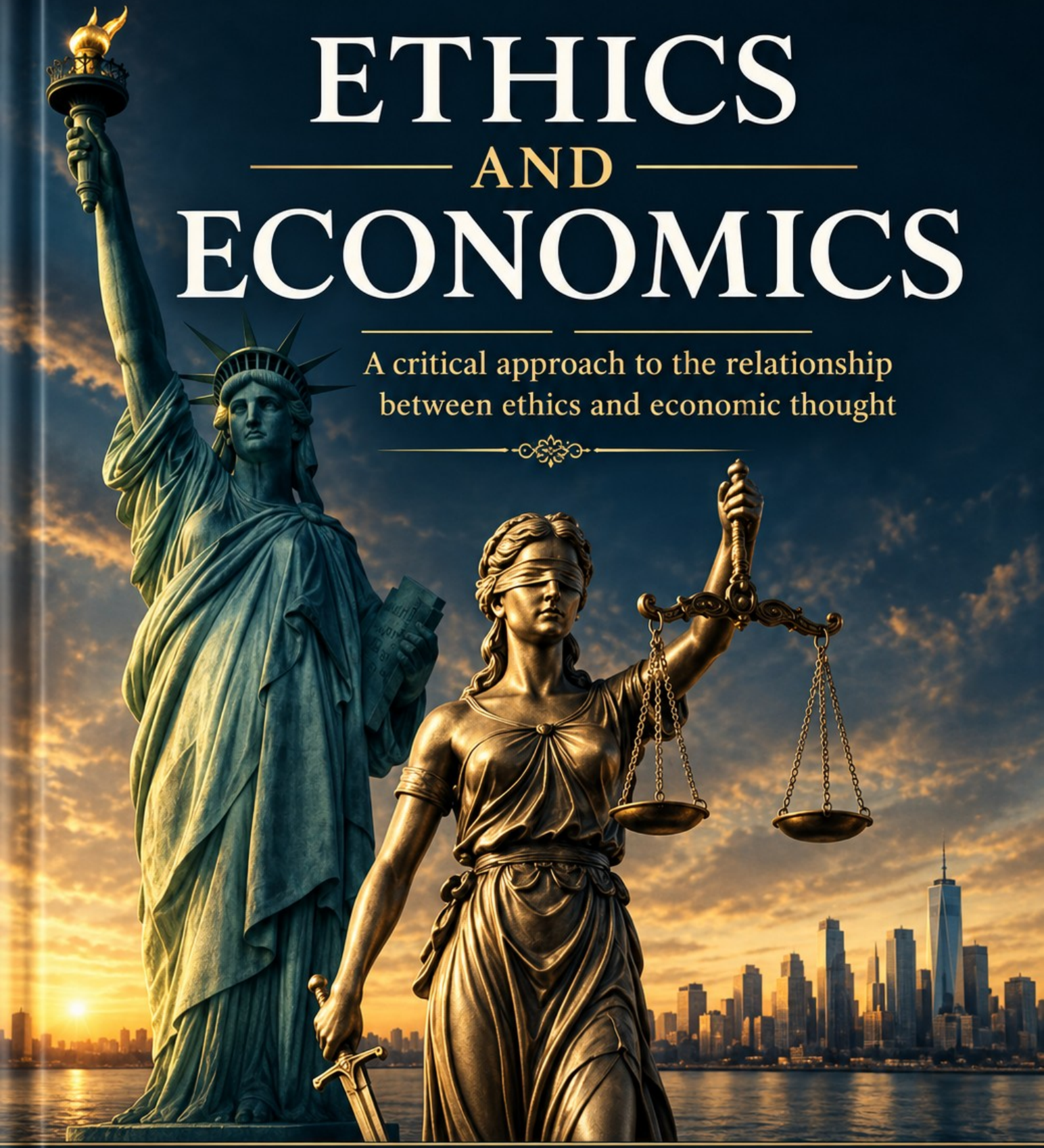
ETHICS AND ECONOMICS

A critical approach to the relationship between ethics and economic thought



NIKOLAOS LIAKOS

PHILOSOPHY • ECONOMICS • SOCIETY

ETHICS AND ECONOMICS: HOW VALUES SHAPE MARKETS

TABLE OF CONTENTS

PART A — Foundations of Ethics and Economic Thought

Chapter 1 — Moral Philosophy and the Major Schools of Thought

1.1 Virtue Ethics (Aristotle, Plato, Socrates)
1.2 Utilitarianism (Bentham, Mill)
1.3 Deontology/Duty (Kant)
1.4 Sympathy/Empathy (Adam Smith, David Hume)
1.5 Advantages & Weaknesses of Each Approach to Economic Decision-Making

Chapter 2 — What Is Economics? Constraints, Models and Values

2.1 The Basic Economic Problem
2.2 Economics as a Science: Positive vs. Normative Approaches
2.3 Embedded Values: Efficiency, Rationality, Maximization
2.4 Forms of Market Organization
2.5 The Ethical Limits of Homo Economicus

PART B — Ethics “Inside” Markets

Chapter 3 — Ethical Motivations in Economic Behavior

3.1 Market Values Through the Lens of Religion
3.2 The Problem of the Compatibility of Adam Smith’s Two Works
3.3 The Concept of “Moral Preference” and Contemporary Models of Behavioral Economics

Chapter 4 — Ethics and Market Failures

4.1 Asymmetric Information, Moral Hazard, Fair Prices
4.2 Externalities and Social Cost
4.3 The Relationship Between Economic Success and Moral Values

Chapter 5 — Profit and Its Limits

5.1 The Philosophical Debate on Profit
5.2 Profit vs. Social Welfare: When Maximization Conflicts with Moral Values
5.3 Corporate Social Responsibility and Business Ethics

PART C — Political Economy & Moral Justice

Chapter 6 — Justice in the Allocation of Resources

6.1 The Subject Matter of Political Economy
6.2 Liberty vs. Equality
6.3 Optimal Allocation According to John Rawls

Chapter 7 — State, Market and the Common Good

7.1 The Role of the State
7.2 Public Goods and Collective Action
7.3 The Golden Mean Between the State and the Market

Chapter 8 — Taxation and Moral Legitimacy

8.1 Why Do We Pay Taxes? The Historical and Philosophical Foundations
8.2 Progressivity, Fairness and Tax Ethics
8.3 Tax Evasion and Tax Avoidance as Moral Hazards and Sources of Social Erosion

Chapter 9 — The Economics of Inequality: Moral Implications

9.1 Economic and Moral Inequality
9.2 When Does Inequality Become Morally Unacceptable?
9.3 Toward a New System of Income Redistribution

Chapter 10 — Technology, Artificial Intelligence and New Ethical Risks

10.1 The Contribution of Technology to Addressing the Basic Economic Problem
10.2 The Future of Work and Human Dignity

PART D — Toward a More Ethical Economic Practice

Chapter 12 — An Alternative Approach to Markets

12.1 Human Well-Being Instead of Efficiency?
12.2 Economics with Embedded Ethical Reasoning

Chapter 13 — Economists and Responsibility: The Ethics of the Profession

13.1 The Influence of Economics on Society
13.2 When Does an Economist Have a Moral Responsibility for Their Predictions?

Chapter 14 — Conclusion: A New Ethics for a New Economic World

14.1 Recapitulation of the Main Conclusions
14.2 Final Positions on How Values Should Be Integrated into Markets and Political Economy

PREFACE — INTRODUCTION

Why the discussion of ethics in economics is more necessary than ever

The confusion between “positivity” and “normativity”

The purpose of the book: bridging philosophy, economics and social reality

This book aims to encourage the reader to reflect on certain concepts of economics and to contribute to the formation of a new economic environment, compatible with what the founders of the free market or other economic systems actually envisioned. There is a misunderstanding concerning the role of the economist, what an economist ought to do, and what the objective purpose of an economic system should be. The book is therefore addressed to everyone, but its influence on professionals in the field—economists, politicians, entrepreneurs and bankers—would be particularly important.

A work focusing on ethics and economics appears to be absolutely necessary because, if we observe the situation, we will find many economists who have a complete lack of knowledge of ethics and political philosophy, while many theorists of politics or philosophy ignore basic elements of economics, such as the basic economic problem, the characteristics of human needs, the factors of production, what a market is, and what we seek to achieve through an economic system. At a higher level, the same applies to the activities of multinational corporations, the banking system, and so forth.

Within this framework, it is necessary to examine the basic principles of economics through the lens of ethics and to distinguish between **means and ends**. The book refers to leading figures in moral philosophy and economics because the lessons we can draw from earlier historical periods, in which these thinkers lived and worked, can and should be transferred to the present day and appropriately adapted so that they are compatible with the new era of the modern capitalist system.

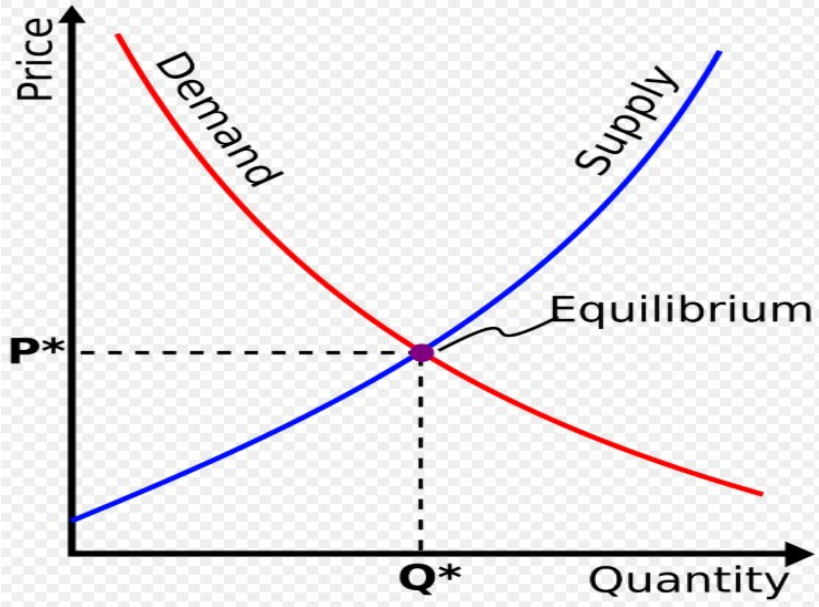
For example, the ethics proposed by Aristotle, who lived in the fourth century BC, or the moral philosophy of the Enlightenment, as we encounter it in the works of well-known Enlightenment thinkers such as Rousseau and Kant, who lived during the seventeenth and eighteenth centuries AD, should be transferred to the modern era and adapted to the requirements of the new economic system as well as to the broader needs of the present age, which differs radically from the societies of the past both in terms of its economic and political systems and in terms of technology, which is constantly evolving. For example, the invention of television and the emergence of social media have had implications for democracy itself and for markets through modern marketing methods. Phenomena such as these will be examined in this book.

The importance of this work is significant for a number of additional reasons. One of them is the confusion that exists between what ought to be done and what actually happens spontaneously as a result of our own nature. This phenomenon was discussed by the well-known Scottish philosopher, historian and economist **David Hume** through what is known as the **"is-ought fallacy."**

Using similar reasoning, supporters of the theory of **social Darwinism** attempted to support their positions. Social Darwinism shares many similarities with the free-market system, and some consider it to be a stage in the evolution of liberalism itself.

Classical economic theory is entirely consistent with the ideology of liberalism and provides, through numerical examples, diagrams, market curves, and so forth, the logical foundations for the theoretical construction of liberalism, adopting a **Newtonian methodology**, which particularly fascinated Adam Smith, also known as the "father of economics."

In this diagram, we can see how the equilibrium price and quantity are determined through the interaction between supply and demand that takes place within a market.



The distinction between what is and what ought to be also forms the basis for the distinction between **positive and normative economics**, and examining the relationship between them constitutes one of the central objectives of this book.

Positive economics deals with facts and is descriptive of the world. It achieves this by adopting certain principles, such as the **basic economic principle**[1] according to which human beings, by their very nature, attempt to maximize their utility or benefit as consumers—that is, the pleasure they derive from consuming particular goods—while, as producers, they attempt to maximize their profit.

This is based on the ethics of **utilitarianism**, which is developed in the first chapter of this book.

According to utilitarianism, human beings are guided by their very nature by two forces: **pain and pleasure**. These determine how people act and what they do.

Incidentally, the well-known utilitarian economist and philosopher **John Stuart Mill** was also the first to refer to the concept of **Homo Economicus**, which is discussed in the second chapter of this book.

Within economics, pain and pleasure have been identified with economic loss and profit. Therefore, according to the basic economic principle, human beings are called upon to make decisions that maximize their utility and minimize their costs, and this is achieved through a process of comparing alternative choices. The second chapter will analyze the tools and models used by economics to make decisions.

But what does it mean to say that economics "deals with facts" and "is descriptive"?

A fact, for example, is the **law of demand** or the **law of supply**, which are presented in the first part of the book and in the second chapter.

The law of demand tells us that when the price of a good or product increases, the quantity demanded (**Qd**)—that is, the quantity demanded by consumers or buyers in general—decreases, and vice versa: when the price decreases, the quantity demanded increases.

A condition for this relationship is that no other determinant of demand changes. If another determinant changes, the entire demand curve shifts and, consequently, the point representing Qd also changes. We therefore cannot isolate the effect produced by a change in price alone. A corresponding relationship applies to the supply of goods.

Reference is made to laws and facts, and in this effort a **Newtonian logic** is adopted, a methodology similar to that used by the natural sciences. In Chapter 3, we will also examine a critique of this model, which may fail to capture reality with complete precision. Nevertheless, it constitutes the best possible methodology for conducting research, even when that research concerns a social science such as economics.

The laws and facts of economics may not be one hundred percent absolute and valid in the same way as the laws of physics. They may nevertheless have statistical validity to a lesser degree—for example, 60% or 80%, depending on the case. This gives us the possibility of speaking about laws and facts even though they are not always confirmed by the actual behavior of participants.

Therefore, one characteristic of positive economics is that its validity can be tested through research or experimentation.

We also mentioned the term "descriptive." It is therefore objective with respect to the drawing of conclusions, reaches specific and usually measurable results, and is not influenced by the subjective opinions and judgments of an economist. It refers to **"what is."**

In contrast, **normative economics** includes value judgments and refers to how things ought to be or what ought to happen, not always in terms of profit or utility maximization, but on the basis of certain principles—that is, social rules and standards of behavior.

There are, of course, normative theories that indirectly base their ethical framework on the axiom of **methodological individualism**, that is, on what is referred to as the "basic economic principle." Such normative economic theories include classical liberalism and its various branches, such as anarcho-capitalism, neoliberalism, social liberalism, the public choice school, the Austrian School,

and so forth. Furthermore, theories such as socialism, mercantilism and communism also belong to this category, as does the broader theoretical framework dealing with concepts related to public goods or the role of the state.

While the laws of positive economics can be tested through research and experimentation, the value judgments of normative economics cannot be subjected to an equivalent test and often constitute merely a guideline or rule that is not objectively rational but is instead based on the bias of a particular scholar.

This has led some to conclude that economics should not be considered a science, or at least that it should be regarded as a social science, similar to political science or philosophy, which are essentially normative.[2]

From this perspective, one can understand how important research into the relationship between **Ethics and Economics** is. This book attempts to bridge the gap between philosophy, economics and social reality.

Before briefly presenting the chapters of the book, we should say a few words about its purpose.

There appears to be a misunderstanding among economists who seem to confuse **means with ends**. Methodological individualism, the economic principle, and the assumption that human beings are selfish, self-interested, and perhaps even "greedy"—seeking to maximize their profit by every possible means and in the most efficient way, which may mean setting aside emotion when it leads to economically inefficient decisions—are all simply working assumptions made by economists. They do not constitute a moral rule of conduct, nor does it follow that the market functions properly when people adopt such an ethic.

This behavioral model is the model of the **economic man (Homo Economicus)**. As we will see in this book, there are studies from foreign universities that compare it to psychopathic or Machiavellian behavior, to borrow certain terms from psychology.

In contrast, economic science, taking this selfish nature of human beings as a given, attempts to redirect their vanity and ambition toward noble ends that simultaneously serve both the human ego and the **common good**, which the average person may not genuinely care about. Within the rules of the market, however, under certain conditions and circumstances, the individual may be "compelled" to serve this good purpose, even though it was not initially among their immediate intentions.

One can certainly criticize whether the reasoning of the Scottish professor can succeed in the real world. Nevertheless, it is undoubtedly an attempt directed toward worthy ends.

What he seeks to tell us is that human beings need certain selfish incentives, such as **profit**, in order to be motivated, and that negative incentives, such as fear of the law, do not provide a genuine motivation for action. Nor is it morally right to demand that individuals sacrifice their personal interests in order to serve other ends selflessly.

It should be remembered that he speaks of a balance between competing interests, something that resembles the concept of **equality**, as we encounter it in other ethical theories, such as those

associated with Karl Marx or socialism. The ultimate goal may be the same, while the means of achieving it are different.

This conclusion is not merely a personal opinion. It is based on the work of **Adam Smith**, the Scottish professor of moral philosophy and economist, who is also known as the “father of economics” because he laid the foundations of economic science through his work *The Wealth of Nations*.

In this work, we can identify the laws of the market, the price mechanism and the concept of price equilibrium, as well as the concept of the **natural price**, which constitutes the ultimate objective of a free market.

Adam Smith supported the labor theory of value, as did Karl Marx, and for this reason I believe there is a misunderstanding concerning the proper role of the economist. Correcting this error is one of the aims of this book. These concepts will be analyzed in greater detail later in the book.

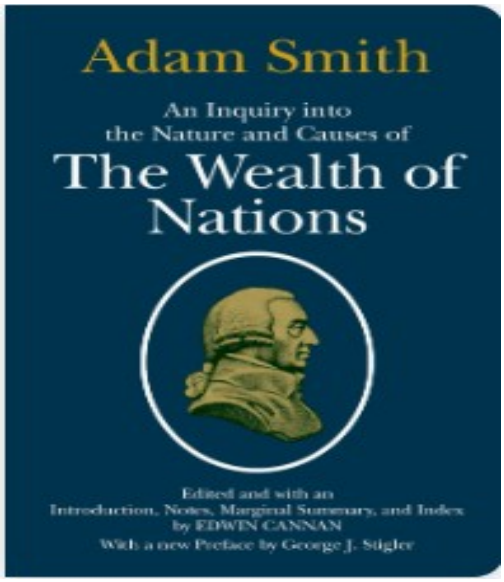
Furthermore, as mentioned above, Adam Smith was a professor of moral philosophy at the **University of Glasgow** and is simultaneously regarded as the “father of economics.” This demonstrates the particularly close relationship between ethics and economics.

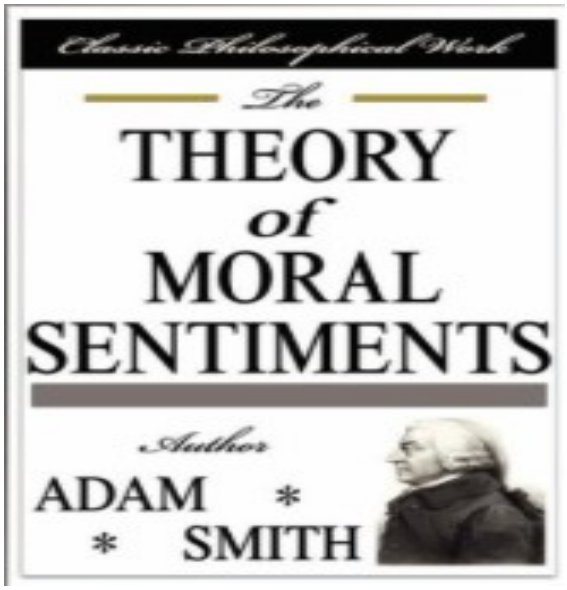
In addition to *The Wealth of Nations*, which presents the functioning of the market and appears to acknowledge and understand the selfish and self-interested nature of human beings, Smith also wrote another work that is less well known and is not often discussed by economists: *The Theory of Moral Sentiments*.

In this work, he focuses on the concept of **sympathy**, in the sense of empathy, and on behaviors that people regard as socially acceptable or blameworthy. He also discusses concepts such as charity and equality, condemns the greed of merchants, focuses on the negative aspects of property, and discusses the role of government, which ought to provide certain public goods and, above all, ensure justice.

Adam Smith wrote *The Theory of Moral Sentiments* in 1759 and was particularly proud of this work. It appears to focus on a different aspect of human nature, and this has created some confusion because the motivations expressed in his two works may appear contradictory. This phenomenon is known as the **“Das Adam Smith Problem”** and is analyzed in Part B of this book, in Chapter 3.

The Wealth of Nations was written in 1776, and therefore *The Theory of Moral Sentiments* preceded it. Finally, there is another part of Smith's overall body of work that is either unknown or lost and concerns poetry, literature, rhetoric, law and politics.





Structure of the Book

This book consists of five parts and fourteen chapters in total.

In the first part, we will examine the best-known schools of ethics and the social rules with which they are associated, as well as some basic concepts of economics. We will conclude the first part by examining certain limits that should govern the **Homo Economicus** model depending on the ethical schools under consideration.

The three main schools of ethics are:

Virtue Ethics

Virtue ethics focuses on the development of a virtuous character, which is the essence of morality. We could associate this school of ethics with certain ancient Greek philosophers, first and foremost **Aristotle**, although other names could also be mentioned, such as Socrates and Plato.

Virtue ethics aims to develop virtuous characters, which is also the essence of the existence of social rules. It emphasizes not so much individual rules and restrictions on human freedom as advice, actions, practices and habits through which we can cultivate a virtuous character, which is the ultimate objective.

When a person has cultivated virtue, external forces are no longer necessary to guide or restrain them. They are able to distinguish good from evil on their own and willingly choose the good.

Virtue constitutes the only barrier capable of preventing the negative side of human nature under conditions of unlimited freedom, that is, under conditions of a state of nature.[3] In such a condition, what "restrains" human defects, weaknesses and passions is consciousness itself. By cultivating a sound conscience, human beings acquire self-control.[4]

The formation of a virtuous character and the cultivation of a sound conscience are primary objectives of the state itself and are referred to in the constitution of our country.[5]

Utilitarianism

Utilitarianism emphasizes the feelings of **pain and pleasure**, which ultimately determine what is moral. Its principal representatives are **Jeremy Bentham** and **John Stuart Mill**.

Utilitarianism is particularly important within the framework of this book because it identifies the essence of morality and is also compatible with human nature, and for this reason it constitutes one of the foundations of economic science.

Together with methodological individualism, utilitarianism forms the two basic components of the **Homo Economicus** model—the hypothetical model assumed in economics, as well as in other disciplines such as politics and sociology, in order to predict human behavior, which in reality is unpredictable.

The model is first referred to by John Stuart Mill himself, and for this reason I will attempt in the first part to demonstrate that utilitarianism—from my perspective—is not so much an ethical theory that gives priority to the whole as one that gives priority to the individual.

Deontology or Duty Ethics

Deontology emphasizes rules and imperatives that a person ought to follow in order to deserve to be considered virtuous. It concerns actions and behaviors associated with a just and virtuous character, without which an action cannot be described as "virtuous." The emphasis, however, is placed on social rules, moral principles and moral law in order to strengthen the social dimension.

The principal representative of the duty-based school is the leading philosopher of the Enlightenment and German Idealism, **Immanuel Kant**, who, through his philosophical reasoning and categorical imperatives, formulated some of the fundamental principles that every human being ought to observe.[6]

Deontology and duty become the basis for what we call **positive law**, while virtue ethics could perhaps be associated with **natural law**. More on Kant and deontology will be discussed in Chapter 1.

These are the principal schools of ethics. They will be analyzed in greater detail in the first part, where we will examine their strengths and weaknesses and consider what they may mean in the modern era, in which different economic systems and models prevail from those of the periods in which these ethical theories were originally developed.

These ethical theories influence economic theory, just as they shape political theory and, consequently, the role of the state, the rules that apply, the extent of freedom, and systems of administration both in the narrow and broader public sector, as well as within private enterprises. In Chapter 9, we will also discuss the concept of **business ethics** and **corporate social responsibility**, whose relationship with moral philosophy is directly connected.

The three ethical theories mentioned—**Virtue Ethics, Utilitarianism and Deontology**—are the dominant schools in the relevant literature on moral philosophy. However, in subsection 1.4 I wish to make a special reference to the empiricist philosopher of the Scottish Enlightenment, **David Hume**, as well as to the "father of economics," Professor of Moral Philosophy **Adam Smith**.[7]

Influenced by other prominent philosophers of the Scottish Enlightenment, such as **Francis Hutcheson**, they emphasized the role of sympathy and emotion in morality. They believed that morality is a product of emotion rather than reason.[8] This stands in contrast to the European Enlightenment thinkers of the same period, who attempted to base morality on reason.

The concept of **sympathy**, a Stoic principle, is employed by Adam Smith in *The Theory of Moral Sentiments*.[9] Sympathy is what makes an action appear socially acceptable or unacceptable and determines when it deserves our approval or disapproval.

This leads to another "invention" of the Scottish philosopher: the concept of the **"impartial spectator"**—the observer who, as a neutral figure unaffected by intense emotion and passions, is able to judge the events taking place around them more fairly.

It should be noted at this point that emotion and virtues are not always good for Smith when they exceed their proper measure. For this reason, in his work on morality we find an early reference to the ancient Greek philosopher **Aristotle** and his principle concerning the mean between two extremes.

This is why special attention is given to sympathy and the role of emotion: because they are directly connected with the cultivation of a virtuous character. Here we can distinguish Smith from other philosophers associated with virtue ethics, such as Plato or Aristotle, who placed greater emphasis on reason than on emotion. The primacy of reason is also developed by the German philosopher **Immanuel Kant**, whose moral law has been identified by some with the “sound conscience” of Smith's impartial spectator. Kant does not completely ignore the role of moral emotion, but regards it simply as a motive leading to moral behavior; more important, however, is for the individual to focus on rules derived from reason and reaching the same conclusion. This position will be analyzed further in the first part of the book.

At the end of Chapter 1, we will examine the advantages and disadvantages of these views with respect to economics, business and the broader functioning of the market, and thus gradually enter the science of economics.

Chapter 2 introduces the reader to economics. It first presents the **basic economic problem**, which constitutes the foundation for every further development of the individual branches of the broader field of economics, such as marketing, business administration, finance, accounting, portfolio management, technical or fundamental analysis, the banking system, and so forth.

All these fields derive from the basic economic problem, and addressing it is something that economists and people participating in the market should have in mind, rather than the personal interests of particular individuals.

Just as, within moral philosophy, the **right to life** constitutes the foundation for every further extension of the field, and we attempt to protect the right to life through the other systems subsequently developed around it—such as political science and law—the basic economic problem can be regarded as the corresponding foundation of economics.

Returning to economics, we have referred to an objective basic economic problem and to the individual sciences that have developed within the broader field of economics. We have also referred to private interests and to an objective purpose that we have in economics: namely, to distinguish the ends from the means.

For this purpose, the distinction between **normative economics and positive economics** is introduced.

Positive economics objectively describes facts concerning market behavior and political economy at both the national and international levels, without introducing personal moral judgments. Normative economics, by contrast, adopts a methodology similar to that of the French-Swiss philosopher **Jean-Jacques Rousseau**, namely, rules concerning what ought to happen rather than what happens according to facts or the spontaneous tendencies arising from our own nature.

As already mentioned, another important difference is that positive economics formulates certain propositions that can be tested and falsified, whereas normative economic theory is based on personal values and cannot be subjected to an equivalent test. This has led some to conclude that economics is not a science, or that it is a social science, and therefore that the methodology of the natural sciences adopted by mainstream economic theory is not compatible with its actual nature, which is closer to political science, sociology and ethics than to physics.

The second part consists of three chapters (Chapters 3–5), which are necessary for drawing conclusions later and finding the appropriate balance between market values and social values—that is, between the pursuit of personal benefit and concern for others.

In addition, we will examine how the economic system provides incentives for ethical behavior, the role of religion and the reciprocal interaction between religion and capitalism,[10] the moral sentiments discussed by Adam Smith in his work, and the seemingly contradictory nature of his two works.

Once this has been established, we will examine the role played by market imperfections and whether there is any relationship between the prevailing model of healthy market competition and the schools of ethics we have studied.

Market imperfections are often caused by impulsive emotional reactions that are spontaneous in human nature and which classical economic theory has ignored by adopting the **Homo Economicus** assumption, although this remains a useful generalization through which a social science can draw certain conclusions.

Nevertheless, because deviations exist, the field of **behavioral economics** developed, and we will examine how ethics can sometimes result in irrational choices. Paradoxically, some irrational or emotion-based choices can often lead to a better outcome for both sides of a relationship or transaction. At this point, **game theory**, and particularly the well-known **prisoner's dilemma**, can be useful.

At the end of Chapter 4, we will examine an interesting study concerning the relationship between moral values and business or economic success. Are what we know about this relationship myths or reality? To what extent does the economic system reward virtue and to what extent does it reward immorality? These are the questions this work seeks to raise in the reader.

Finally, Part II concludes with Chapter 5, in which we explain the role of profit in our economic system, its positive impact, as well as the negative side effects that accompany it and which we should attempt to eliminate while preserving its positive elements—for example, the role of profit in the business cycle and the alternation between growth and decline, crisis and recession, or stagnation.

In order to achieve the above objective, namely to eliminate the negative elements of profit, the concepts of **business ethics** and **corporate social responsibility** are introduced. At this point, I would like us to consider whether businesses actually fulfill this role and what truly constitutes “social responsibility.” All views and arguments will be presented, and I would like the reader to reach their own conclusions, although I will also present my personal view either at this point or in the final conclusions of the book.

In Part III (Chapters 6–10), we initially examine views and theories concerning a fair distribution of resources and the role that the state is called upon to play within this framework.

The book maintains a neutral position toward the various ideologies across the political and economic spectrum. Its objective is to help the reader reach their own conclusions concerning the optimal point of balance between the state and the market, individuals and government, and the balancing of interests within society.

In the fourth and final part, we will examine how the social role of the economist could change in the future and whether a different system capable of achieving a better balance would be feasible. Perhaps it would not necessarily be radically different, but certain new additions could significantly alter the functioning of domestic and international political economy.

In concluding this preface and introduction to the book, I cannot omit my personal view on these issues, and I would be pleased to discuss them with anyone who wishes to do so.

Personally, I believe that every ideology and every theory relating to political or economic theory, as well as every historical period of humanity, has something to teach us and contains a piece of the puzzle of truth.

There is therefore no single and distinct idea that possesses absolute truth. Political, ethical and economic theories that appear to contradict one another are, in reality, not necessarily competitors or substitutes for one another, but rather necessary complements through which one can approach the truth, which ought to constitute the objective purpose of scientific research.

Nevertheless, the mixture of truth is not necessarily distributed uniformly among all these theories of ethics—and therefore of politics—and economics. There may consequently be either symmetry or asymmetry between them. This is what we address in Parts III and IV: how to find the correct point of balance, or the **golden mean**, between the interests of different social groups, so that a just system can be formed which respects everyone's right to life and also promotes economic prosperity.

Let me conclude with a few words from the well-known British economist **John Maynard Keynes**:

> “The political problem of mankind is how to combine three things: economic efficiency, social justice and individual liberty.”

Nikolaos Liakos
Rhodes, September 2025

---

1 Maria Ioannou-Serghiou, Neofytos Savvas et al., *Economics for the 1st Grade of Lyceum*, Diophantos Publications, 2020.

2 Karl Popper describes the way of distinguishing between science and “pseudoscience.” The criterion by which one can recognize them is whether they can be verified through experimentation, while the focus should not be placed on the data that confirm a hypothesis but on the data that falsify it. True science puts its axioms to the test, whereas pseudoscience simply confirms them.

3 Precisely because it is connected with the state of nature—that is, a condition of absolute freedom in which there is no authority to restrain human nature—it is also referred to later by Enlightenment philosophers such as Jean-Jacques Rousseau and by thinkers of German Idealism such as Adam Weishaupt.

4 Stella Sotiriou, Styliani Kordonouri, Aikaterini Zafranidou, *Social and Political Education, 3rd Grade of Gymnasium*, p. 44.

5 Personally, I prefer this ethical school and view all of the schools together as complementary to one another rather than as competitors or substitutes.

6 Kant's fundamental categorical imperative is presented in his work *Groundwork of the Metaphysics of Morals*. In other works, such as *Toward Perpetual Peace: A Philosophical Sketch*, Kant refers to a series of preliminary and definitive articles that delimit states, in much the same way that the law of the state delimits and restricts the individual within society. Finally, in his work *Religion within the Boundaries of Mere Reason*, he explains what the proper role of religious authority and religion ought to be and, consequently, what additional moral principles it embraces and supports. This formulation of his views indirectly reveals the methodology through which deontology attempts to achieve its aims—for example, the Ten Commandments received by Moses on Mount Sinai, as well as other references found in the Old and New Testaments in that work and in other religions, whether monotheistic or polytheistic. Their purpose is to promote the cultivation of virtue through moral laws and rules, each from its own perspective and with emphasis on different values, just as the various schools of ethics examined in the first part do. For Kant, therefore, religion constitutes a “noble lie” (to borrow a term from Plato), which is positive on the one hand because it is noble, and negative on the other because it is a lie.

7 Adam Smith was a Professor of Moral Philosophy at the University of Glasgow during the 1750s and taught there before becoming internationally known for his work on “economics.” He taught moral philosophy and philosophy of law, and his lectures led him to write *The Theory of Moral Sentiments*.

8 Indeed, modern neuroscience confirms these conclusions.

9 Sympathy has more precisely the meaning of empathy. It is what connects our self-interest with our concern for others. As Smith explains, sympathy arises spontaneously, comes from within us, and becomes stronger the closer someone is to us or the more similar we are to them.

10 For the relationship between them, I refer the reader to Max Weber's well-known work *The Protestant Ethic and the Spirit of Capitalism*.

PART A — FOUNDATIONS OF ETHICS AND ECONOMIC THOUGHT

CHAPTER 1 — ETHICAL PHILOSOPHY AND THE MAJOR SCHOOLS OF THOUGHT

What is it that distinguishes good from evil? What action is considered “good” and what action is considered “bad”? Are good and evil subjective, or is there an objectively good or objectively bad? What kinds of behavior are associated with ethics?

We have already briefly mentioned the main schools of ethics in the Introduction. In this first part, we will examine them in greater detail:

1.1 Virtue Ethics (Aristotle, Plato, Socrates)

Virtue ethics, I would argue, rightly deserves to be mentioned first among the schools of ethics, not only because the philosophers associated with it whom we will discuss here lived historically earlier than the philosophers of the Enlightenment or modernity, but also because it constitutes the foundation and essence of moral philosophy as a whole.

The ethical theories we will examine later constitute necessary complements to virtue ethics and, personally, I do not see them as entirely separate or completely opposed to it. I will develop this argument further as I analyze the other schools of thought. Both utilitarianism and deontology, I would argue, deal with different aspects of virtue ethics. This, however, is my personal assessment and is not based on the work of another scholar.

Virtue ethics is a moral philosophy that focuses on cultivating character and developing virtues rather than relying primarily on rules or consequences.

A virtuous character does what is right by itself, without needing the restriction or fear of the law. Consequently, there is less need for an external body of authority to restrict individual freedom, leaving less room for the abuse or exploitation of power.[11]

A virtuous character is achieved when an individual develops a sound conscience[12] and is therefore capable of exercising self-control and discipline without requiring an external force to control them. For this reason, such a person can follow moral rules more effectively because they genuinely feel and believe in them.

If a person's character has not been trained to be virtuous, they cannot follow rules with the same ease. They may instead experience rules as an obligation imposed upon them by force, without experiencing any corresponding benefit or pleasure. The rules appear foreign to them, something that comes “from outside” rather than something that originates within themselves.

Furthermore, when a person's character is genuinely virtuous, their goodness is authentic. By simply following commands, rules or consequences, however, behavior may become hypocritical,

manipulative or motivated by self-interest, especially when the individual follows rules solely because of the consequences of their actions.[13]

Essentially, virtue ethics is an ethics of **excellence**, in which the central question is how a person can become virtuous in order to live a happy life, according to Aristotle.

Virtue ethics became associated with the political system of **aristocracy**, according to which the "best" are considered the most worthy to govern. But according to what criteria do we determine who is worthy?

Aristotle, Plato and Socrates are names that can be mentioned here, particularly Aristotle, with whom virtue ethics is primarily associated. For all of them, virtue does not derive from wealth but from human wisdom or the wisdom of the ruler. Wisdom is what makes a person virtuous.

In the modern era, however, as we will show later, the development of markets and finance and the role of money can transform aristocracy into **oligarchy**, with money taking the place once occupied by wisdom. People without wisdom can therefore acquire a glory that, in reality, does not belong to them.

We will examine aristocracy and oligarchy later, as we analyze the philosophers associated with virtue ethics. For the moment, it is sufficient to say that capitalism has the tendency to transform every political system into some form of oligarchy—that is, a system in which the wealthy govern directly. The difference is that when a political system is not formally oligarchic, the dominance of the wealthy is exercised indirectly.

Aristotle

Let us return to virtue ethics and begin with the great ancient Greek philosopher from Stagira in Macedonia, **Aristotle**.

Aristotle (384–322 BC) was one of the most important philosophers of antiquity and one of the most influential thinkers in the history of the Western world. He was a student of Plato and later became the teacher of Alexander the Great.

He was born in Stagira in Macedonia, specifically in Chalcidice. Aristotle studied at Plato's Academy for twenty years. Plato was therefore Aristotle's teacher, and, as we will see, Plato himself was a student of Socrates.

Aristotle founded the Lyceum in Athens around 335 BC, a philosophical school that became known as the **Peripatetic School**, because teaching took place while walking along the colonnades of the Gymnasium near the Temple of Apollo Lyceus. He subsequently developed the Peripatetic philosophical tradition. He eventually died in Chalcis.

Aristotle studied almost every field of human knowledge, including:

- Philosophy and Logic, in which he introduced systematic logic
- Ethics and Political Philosophy
- Physics and Biology
- Metaphysics
- Rhetoric and Poetics

His thought deeply influenced:

- medieval philosophy,
- science,
- political theory,
- modern logic.

Many of his works became foundational texts of Western intellectual history.

For Aristotle, cultivating a virtuous character is the fundamental objective. This can be achieved through habits: by repeatedly performing good actions, we practice virtue and acquire what he calls **eudaimonia**. We will understand this more clearly as we examine other schools of thought and consider whether they should be viewed separately, or as complementary and combined approaches.

Aristotle's ethics is based on virtue and the **mean**. He encourages us to seek the golden mean between two extremes of a situation or characteristic, because extreme conditions generally do not promote the good.

Notice that, in this sense, even virtues could appear as vices if they are taken to extremes. We will encounter a similar issue later when we discuss sympathy and moral emotions in the work of the Scottish theorist of moral philosophy and economics, **Adam Smith**.

Some examples illustrate Aristotle's ethics:

- Cowardice — **Courage** — Recklessness
- Miserliness — **Generosity** — Wastefulness
- Insensitivity — **Gentleness** — Irritability
- Isolation — **Friendliness** — Excessive sociability
- Suspicion — **Trust** — Naivety
- Laziness — **Diligence** — Workaholism

Through these examples we understand Aristotle's ethics and his recommendation that we seek the golden mean.

Some additional characteristics associated with a virtuous character according to Aristotle include:

- confronting problems;
- maintaining the mean and seeking the golden mean;
- recognizing the value of friendship and finding friends who elevate and complement us;
- truthfulness and sincerity in life;
- discovering our passion in life and work;
- constantly improving our character.

Aristotle famously states:

> “A friend is a single soul dwelling in two bodies.”[14]

The happiness of one's friend becomes one's own happiness, and their sorrow becomes one's own sorrow.

It is also important to consider several statements attributed to Aristotle:

> “The wise man should not merely give orders but should command, and it is not he who should obey others, but the less wise who should obey him.”[15]

> “What I gained from philosophy was the ability to do willingly what others do because they fear the laws.”[16]

These statements illustrate again the idea that a virtuous individual may stand above the law of the state. Immanuel Kant later uses the concept of divine law in contrast to human law—that is, the law of the political community—in *Religion within the Boundaries of Mere Reason*. This cultural attitude can also be seen in Sophocles' *Antigone*, the ancient Greek tragedy probably first performed at the Great Dionysia in 441 BC.

Aristotle also states:

> “It makes no difference whether laws do not exist or whether they are not enforced.”[17]

> “Instead of trying to correct the people who cause great injustices in society, it is necessary to correct the weakness of those who endure them.”

> “The gentle and noble person behaves as though the law were within him. Thus he exercises authority in company through his good manners and noble behavior.”[18]

> “Ethics is the habit that leads us to do what is right, choosing the mean between excess and deficiency, as determined by right reason.”

> “Happiness is not found in wealth, but in peace of mind.”[19]

> “The whole value of becoming wealthy lies in its use, not in its possession.”[20]

These passages help us understand what virtue means for Aristotle. They show that he focuses on human character and seeks to make people follow moral rules voluntarily and willingly, without requiring an external authority or guardian to guide them.

Virtue is therefore a necessary complement to a natural condition of absolute individual freedom. Without virtue, unlimited freedom can lead to lawlessness, exploitation and injustice, without respect for people's rights—not even the first and most fundamental right of all, the **right to life**.

Aristotle classified ideal forms of government as follows:

1. **Monarchy**
2. **Aristocracy**
3. **Polity**

These classifications apply when each political system operates in accordance with the public or common interest.

When, by contrast, the personal interests of the ruler or representatives of the people dominate, the corresponding forms of government become:

1. **Tyranny**
2. **Oligarchy**
3. **Democracy**[21]

Aristotle regarded as the ideal form of monarchy one in which the ruler functions as an earthly representation of the god Zeus, which points toward a theocratic model of political authority.[22]

Plato

Another philosopher of antiquity who shared this ethical outlook and warned about the dangers of unlimited freedom, while also criticizing democracy itself, was **Plato**. His thought is important for the present discussion because it supports the ethics of virtue.[23]

Plato was one of the most important philosophers of ancient Greece and one of the most influential figures in the history of world thought.

He was born in Athens around 427 BC.

- He was a student of Socrates, whom he regarded as his intellectual father.
- After Socrates' death, he travelled to Egypt, Italy and Sicily.
- Upon returning to Athens, he founded the Academy, the first institution of higher education in the Western world.
- He taught there for approximately forty years.
- He died around 347 BC.

He wrote mainly dialogues, in which ideas are presented through conversations. Some of his best-known works include:

- *The Republic* — concerning justice and the ideal state
- *Symposium* — concerning love
- *Phaedo* — concerning the immortality of the soul
- *Timaeus* — concerning the creation of the world
- *Cratylus*, *Sophist*, *Phaedrus*, *Gorgias*, and others.

Here we will focus only on the ethical aspect of virtue and will not examine Plato's entire body of work.

Plato also held interesting views concerning economic organization and the economic problem. He supported the division of labor and a relatively simple way of life, possibly as a solution to the basic economic problem.

He also believed that hierarchy and inequality between classes were necessary for an effective system of governing the city. In *The Republic*, he addresses issues relating to population and has sometimes been regarded as one of the earliest thinkers associated with ideas resembling social Darwinism. He describes an ideal state characterized by hierarchy and class inequality, in which the upper classes govern, and suggests that reproduction should take place only among members of the appropriate class because they possess characteristics that should not be diluted.[24]

The word “eugenics” appears in several passages of *The Republic*, which is one reason why some commentators have associated Plato with social Darwinism.[25]

Plato criticized democracy because he regarded it as a weak system incapable of controlling society, in which those genuinely qualified to hold positions of authority do not necessarily obtain them.

Although he identifies aristocracy, in which philosophers rule, as the ideal form of government, in the historical period in which he lived he regarded militaristic Sparta rather than democratic Athens as the ideal state.

The Philosopher-King and the Noble Lie

Two of Plato's ideas are particularly relevant here:

1. The Philosopher-King

The “philosopher-king” refers to Plato's idea of the ideal ruler: a person who loves wisdom, has access to genuine knowledge, and is guided by reason and morality with the objective of promoting the well-being of the political community.

As described principally in *The Republic*, the philosopher-ruler, like the pilot of a ship, must be capable of distinguishing truth and goodness and guiding the city wisely, away from the illusions of mere experience, while always being guided by justice.

2. The Noble Lie

The “noble lie” is a famous concept presented by Plato in *The Republic*, Book III. It is a deliberately constructed narrative told by rulers to citizens in order to secure social harmony and stability.

According to this myth:

- everyone is born with a different “nature” or “metal” within them;
- consequently, people naturally belong to different social classes.

Some possess:

- gold — the rulers/philosophers;
- silver — the guardians;
- iron or bronze — the producers.

The myth maintains that the city is like a family because everyone was born from the same “Mother Earth,” but with different metals in their souls.

It is called “noble” because Plato regards it as a lie with a good purpose: to lead society toward justice and order—even through a myth.[26]

Combining these two principles, we arrive at the conclusion that people of “golden metal” possess the characteristics of potential leaders: a virtuous character, justice and a love of wisdom.

Plato states:

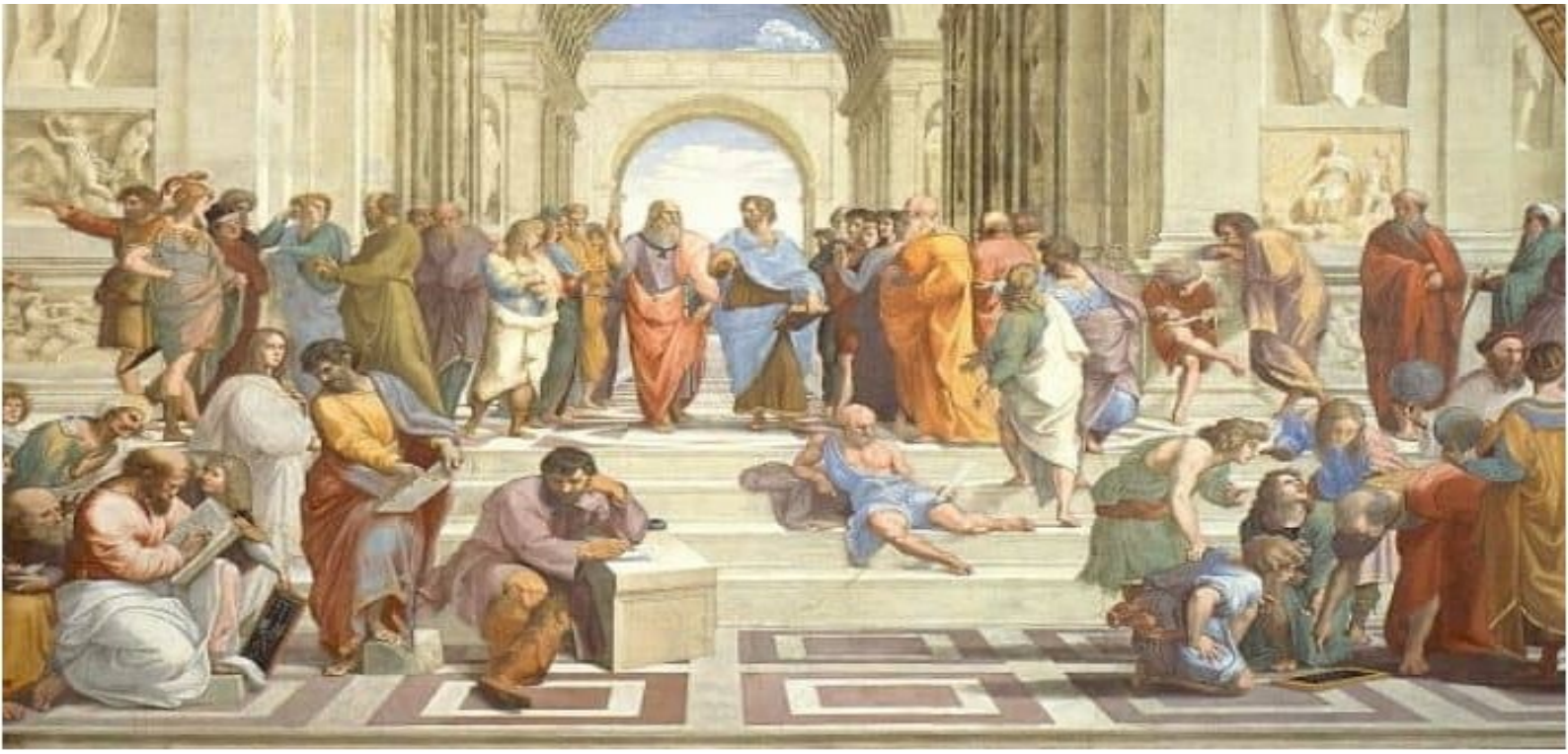
> *“Laws are made to guide the good man toward complete virtue and to restrain the bad man, who because of the hardness of his heart is not easily prevented from committing crime.”*[27]
>
> *“Man, when perfected, is the best of creatures; but when separated from law and justice, he becomes the worst of all.”*[28]
>
> *“All the gold that lies above and beneath the earth is not worth as much as virtue.”*[29]

> *“Is the good good because it pleases the gods, or does it please the gods because it is good?”*[30]

> *“True political art should concern itself not with private but with common interests, because private interest divides while common interest unites the political community.”*[31]

From these passages we can conclude that, for Plato, there are conscientious characters who are not primarily restrained by the state but by something resembling an internal “invisible force” originating within them.

Plato and Aristotle.



The defining characteristic of such a character is the priority given to the common good, even at the expense of personal interest when the two come into conflict.

For Plato, the value of such a character is comparable to gold, and this category of people constitutes the social class that legitimately deserves to govern.

Socrates

Finally, I would like to say a few words about **Socrates**, whose name is a powerful addition to the defense of virtue ethics.

Socrates (approximately 470–399 BC) was an ancient Greek philosopher from Athens and is widely recognized as one of the founders of Western philosophy.

He was known for teaching through dialogue and questioning, a method known as the **Socratic method** or **maieutics**.

He left no written works. His ideas and philosophy are known exclusively through the accounts of his students, primarily Plato and Xenophon, as well as the comic poet Aristophanes and Aristotle.

Socrates shifted the focus of philosophy away from the study of the natural world, which had characterized the Presocratic philosophers, toward ethics and the way human beings ought to live.

He believed that happiness derives from living an ethical life and encouraged people to pursue justice and goodness.

Socrates died in Athens in 399 BC. He was accused of:

1. corrupting the youth;
2. impiety toward the traditional gods of the city.

He was executed by drinking hemlock.

His philosophical method involved asking a series of questions designed to encourage his interlocutors to examine their own beliefs and discover the truth for themselves.

This is reflected in several famous statements attributed to him:

> *"The only thing I know is that I know nothing."*[32]
>
> *"True wisdom comes to each of us when we realize how little we know about life, ourselves and the world around us."*[33]
>
> *"I cannot teach anybody anything. I can only make them think."*[34]
>
> *"Those who tell you what you should do and what is right for you do not want you to find your own answers. They want you to agree with theirs."*[35]
>
> *"Education is the lighting of a flame, not the filling of a vessel."*[36]

These statements illustrate his pedagogical method and broader worldview: his desire was to form autonomous individuals capable of thinking for themselves and exercising critical judgment.

No one possesses absolute truth, and an attempt to shape truth or reality may conceal ulterior motives or some form of hidden purpose.

Socrates appears more liberal in certain respects, giving priority to the individual in relation to the state and approaching what could be called an **open society**, in which the state does not impose rules upon citizens in every aspect of their lives, since no one possesses absolute truth.[37]

His social outlook also extends beyond the individual, the city or the state and reaches humanity as a whole.

Some additional statements attributed to Socrates include:

> *"If a man is proud of his wealth, he should not be praised until it is known how he uses it."*[38]
>
> *"Prefer knowledge to wealth, because wealth is temporary whereas knowledge is eternal."*[39]
>
> *"There is one good, knowledge, and one evil, ignorance."*

“Nature has given us two ears, two eyes, but one tongue, so that we may hear and see more than we speak.”[40]

“He who wishes to change the world must first change himself.”[41]

“The most effective way to live honorably in this world is to be what we pretend to be.”[42]

“Pay attention to the burden of a busy life.”[43]

“I am neither Athenian nor Greek, but a citizen of the world.”[44]

“No man understands an art he has not learned, not even the simplest one. Yet everyone believes himself sufficiently qualified for the most difficult of all arts, the art of governing.”[45]

“I wish ordinary people had an unlimited capacity for doing evil, because then they would also possess an unlimited capacity for doing good.”[46]

“The measure of a man is what he does with power.”[47]

“Democracy is only as good as the education surrounding it.”[48]

“I would rather die than live without freedom.”[49]

“Wine takes the shape of its bottles, and wealth takes the shape of the characters of those who possess it.”[50]

“Is the good good because it pleases the gods, or does it please the gods because it is good?”[51]

From these statements we can draw several conclusions about the ethical character Socrates considers virtuous.

A person is not virtuous merely because they possess money. This is particularly important because aristocracy, when combined with wealth, tends toward oligarchy.

Knowledge is preferable to wealth. Therefore, aristocracy should be associated with knowledge rather than money.

A person ought to continue learning throughout life, and freedom entails responsibility. In order to judge correctly as citizens in a democratic political system, we must be adequately educated for that purpose.

Socrates does not necessarily seek to replace democracy with another form of government, as Plato or Aristotle might. Rather, he criticizes the role of the citizen and the extent to which citizens fulfill their obligations toward the political community.

He also appears as a cosmopolitan thinker, in contrast to Plato and Aristotle, who have a more national or ethnic perspective.

We can also identify certain principles resembling liberalism or even anarchist thought: power that can be used to do good can simultaneously be used to do evil. This may support limiting political power in order to prevent rulers from abusing it.

However, limiting abuse of power also weakens the state and may prevent it from fulfilling its obligations toward society.

Socrates is particularly interesting for the framework of this book because he can be connected with the concept of the free market we will develop later. Unlike the other philosophers, he combines virtue ethics with a relatively liberal spirit.

Although he could be described as an advocate of individualism,[52] Socrates nevertheless believes that the public interest should prevail over private interest, even when the issue concerns the individual.

A common element can therefore be observed among all three philosophers: **they place the common good above individual interest**.

1.2 Utilitarianism (Bentham, Mill)

Before discussing **utilitarianism** and related theories such as hedonism, we should first discuss the concept of morality and how we define what is moral and immoral.

In the broader literature, an action is generally characterized as moral when it increases pleasure and immoral when it produces pain.

These two forces—pleasure and pain, or happiness and suffering—shape human happiness. They therefore determine when an action can be characterized as moral or immoral.[53]

Utilitarianism should not be viewed simply as a rigid form of consequentialism or as an entirely practical logic. It is a theory situated at the heart of ethics, and for this reason economics may be justified in adopting it as part of its methodology.

However, as we have already argued, all these ethical theories should function as complements to one another. Utilitarianism can therefore be understood as a necessary complement to virtue ethics and deontology.

When, for example, someone insults, threatens or directly uses violence against another person, they cause pain and their action can therefore be characterized as immoral.

Conversely, when someone benefits others through their actions, they produce pleasure. For example, when a mother prepares food for her family, this increases pleasure and can therefore be regarded as a morally correct action, regardless of whether her motives include ego satisfaction or personal ambition.

Similarly, the entertainment industry, music industry, sports and other forms of entertainment produce positive experiences and increase immediate pleasure.

One may disagree about the qualitative value of these goods, but they nevertheless increase pleasure. This was one of the criticisms directed against utilitarianism: that it might promote things that are not intellectually or spiritually significant.

Hedonism

Before continuing with utilitarian ethics and discussing Jeremy Bentham and John Stuart Mill, we should examine **hedonism**, which preceded utilitarianism and may be regarded as one of its ancestors.

Hedonism is a philosophical theory according to which the highest good and ultimate purpose of human life is pleasure and the absence of pain.

Good, therefore, is whatever produces pleasure, while evil is whatever causes pain.

The theory developed in antiquity. Its principal representatives included **Aristippus of Cyrene**, who emphasized immediate bodily pleasures, and **Epicurus**, who gave hedonism a more moderate form.

Epicurus was concerned with happiness and with what provides human beings with happiness.

There are therefore similarities between these philosophers and the differences between Jeremy Bentham and John Stuart Mill. Aristippus emphasized bodily pleasures, much as Bentham did not exclude any form of pleasure, whereas Epicurus focused more strongly on pleasures of the mind.

Epicurus of Neocles, from Gargettus (Samos, 341 BC – Athens, 270 BC), was an ancient Greek philosopher. He founded his own philosophical school, the **Garden of Epicurus**, which became one of the most famous schools of Greek philosophy.

For Epicurus, the greatest form of happiness is **ataraxia**—peace of mind, tranquility and inner calm.

He emphasized self-control and the avoidance of unnecessary desires. He preferred simple pleasures.

A calm and simple way of life, avoiding the anxiety that produces pain, is therefore a hedonistic position in the Epicurean sense.

His advice could essentially be summarized as:

Sacrifice pleasure in order to avoid pain.

Epicurus also recommended studying philosophy throughout one's life, relying on oneself rather than external factors, cultivating good friendships, avoiding the pursuit of fame and excessive wealth, and defining success according to one's own values.

Ultimately, what matters is peace and tranquility of mind.

Modern economic theory later associated pleasure, at least in part, with profit in the market.

This alternative conception of happiness raises an important question: perhaps there are forms of profit beyond monetary profit. Perhaps human happiness can be achieved through alternative means rather than exclusively through financial gain.

It is also worth noting that **Karl Marx wrote his doctoral dissertation on Epicurus**, and that the communities he theoretically envisioned in Marxist thought were influenced in certain respects by the Epicurean community.

Utilitarianism

Hedonism focuses on **individual pleasure**, whereas utilitarianism focuses on the **overall happiness of all**. Utilitarianism is a moral philosophical theory according to which an action is morally right when it produces the greatest possible benefit or happiness for the greatest possible number of people.

Its main principles are:

- actions are judged according to their consequences rather than their intentions;
- “benefit” generally means happiness, pleasure or well-being;
- everyone counts equally: the happiness of one person is not inherently worth more than that of another.

I would nevertheless argue that its original thinkers may have had a somewhat different perspective, one that placed considerable importance on the individual. John Stuart Mill himself was associated with the development of the concept of **Homo Economicus**.[54]

Mill states:

> *"The only freedom which deserves the name is that of pursuing our own good in our own way, so long as we do not attempt to deprive others of theirs, or impede their efforts to obtain it."*[55]

Taking this statement into account, together with Mill's definition of *Homo Economicus* in *On the Definition of Political Economy* (1836), it would be incorrect to associate Mill's utilitarianism simply with a theory that gives priority to society over the individual.

I would argue instead that he had something resembling what later became known as **Pareto optimality**.[56]

Mill is generally regarded as a classical liberal thinker. He therefore cannot easily be associated with an ethical theory that would give absolute priority to the collective over the individual or sacrifice minorities for the sake of the majority.

As a classical liberal, Mill believed that the rights and happiness of each individual matter and that we should not simply "count heads" when making moral, economic or political decisions.[57]

Consider an example.

If utilitarianism is interpreted simply as a theory that maximizes the utility or welfare of the broader society, then one might conclude that the interests of an individual should be sacrificed for the interests of the majority.

For example, it might be considered morally permissible to take money from one individual and redistribute it among others if doing so maximizes collective welfare.

Similarly, if one person needs an organ transplant to survive while several other patients could survive if that person were sacrificed, utilitarian reasoning raises the question of whether one individual could morally be sacrificed for the benefit of several others.

These examples reveal one of the major weaknesses of utilitarianism.

Utilitarianism focuses on the **consequences** of actions rather than their intentions. Its objective is to maximize utility for the greatest number of members of society.

This ethical theory became closely connected with economics. Economic theory adopts a model in which **profit is identified with pleasure**, while financial loss is identified with pain.

This made utilitarianism particularly compatible with economics.

Another reason for its influence is that pleasure and suffering can, at least theoretically, be measured. This is particularly convenient for a social science that adopts a Newtonian methodology and seeks to borrow some of the prestige of the natural sciences.

Utilitarianism has important advantages. It can motivate individuals effectively because it corresponds to two fundamental forces of human nature: **pain and pleasure**.

Deontology, by contrast, may not provide individuals with equally powerful incentives.

Critics of utilitarianism, however, point to its tendency to justify the oppression of individuals or minorities for the benefit of the wider society.[58]

If we focus exclusively on the consequences of actions, we may arrive at the principle that **"the end justifies the means."**

Nevertheless, we should remember that a theory may describe how things actually operate in the real world and then use this as an axiom or empirical starting point for guiding individuals toward socially desirable objectives.

In this sense, utilitarianism can be regarded as a necessary complement to virtue ethics rather than as a theory that necessarily oppresses individuals or minorities or ignores the common good in favor of personal interest.

1.3 Deontology/Duty Ethics (Kant)

Deontology, as an ethical theory, refers to the set of rules and values that determine correct or incorrect behavior within a particular field or profession.

The word **deontology** derives from the Greek words *deon* ("what ought to be done") and *logos* ("reason" or "thought").

Deontology therefore concerns the study of how we ought to act and the moral rules governing a particular activity.

The German philosopher **Immanuel Kant** undoubtedly belongs to this category.

Kant was one of the leading philosophers of the European Enlightenment and German Idealism. He is particularly famous for his categorical imperatives and his conception of the moral law.

One formulation of the categorical imperative is:

> "Act only according to that maxim through which you can at the same time will that it become a universal law."[59]

In other words, we can determine whether an action is morally correct by asking what would happen if everyone acted according to the same principle.

Immanuel Kant is regarded as one of the most important thinkers and philosophers of all time and perhaps the greatest philosopher of the modern era.

He was born in 1724 and died in 1804 in Königsberg, now Kaliningrad.

His family were Lutheran Christians and specifically belonged to the Pietist tradition.

Pietism emphasized personal piety, moral life, discipline and inner faith.

Kant attended a school characterized by strict Pietist education and remained a Protestant Christian.

Although he later distanced himself from dogmatic religion, his emphasis on duty, conscience and moral responsibility clearly has roots in his Pietist upbringing.

Some of his major works include:

- *Critique of Pure Reason* (1781), concerning the limits of human knowledge;
- *Critique of Practical Reason*, concerning ethics;
- *Critique of Judgment*, concerning aesthetics and judgment;
- *Groundwork of the Metaphysics of Morals* (1785);
- *The Metaphysics of Morals* (1797);
- *Toward Perpetual Peace* (1795);
- *Idea for a Universal History with a Cosmopolitan Aim* (1784);
- *Religion within the Boundaries of Mere Reason* (1793);
- *Anthropology from a Pragmatic Point of View* (1798).

This list does not constitute the entirety of Kant's works, but it provides, in my view, a satisfactory starting point for anyone wishing to understand his philosophy.

I will not discuss all these works in detail. Instead, I will describe Kant's ethical theory as I understand it through these works, while leaving room for the reader to arrive at a different interpretation.

Kant attempted to ground morality in **reason rather than religious tradition**. In simple terms, he sought to replace religious authority with reason.[60]

For Kant, the average person is more likely to follow moral rules effectively if they understand the objective reasons why they ought to obey a rule than if they simply believe that the rule originates from a divine being.[61]

Just as Plato developed the idea of a "noble lie" for a good purpose,[62] religion can be understood as employing a similar mechanism in order to secure social cohesion and moral behavior.

For Kant, however, one of the fundamental principles of duty is:

Never lie, even when the lie is motivated by good intentions.

Kant therefore opposed religious authority when it attempted, through falsehood, superstition and fantasy, to keep human beings dependent on a condition that was no longer appropriate to their intellectual development.[63]

Kant is often regarded as a philosopher of freedom and is sometimes associated with classical liberalism.

His famous motto is the Latin phrase **sapere aude**—"dare to use your own understanding."

He believed that people ought to think for themselves rather than depend upon external forces that might manipulate or exploit them.

This resembles the classical liberal principle of skepticism toward authority.

At the same time, Kant should not be associated with anarchy. He was a defender of freedom, but not of anarchy. He believed Christianity occupied a position between despotism and anarchy.[64]

For Kant, anarchy appears to involve not simply the absence of central authority but the absence of the moral framework associated with Christianity.

In *Religion within the Boundaries of Mere Reason*, he suggests that without such morality humanity would find itself in a condition resembling Rousseau's state of nature, a condition of conflict in which human beings cannot coexist peacefully and turn against one another.[65]

Kant does not consider human beings inherently evil. Rather, he argues that they possess a **propensity toward evil**.[66]

Because human beings possess such defects, it is impossible to create a political authority capable of completely guiding humanity toward virtue, because that authority would itself be composed of human beings possessing the same defects.

Kant therefore considers a universal federation or union of peoples necessary as a final stage in humanity's political development.[67]

Even such a union could fail or potentially develop into a form of despotism.[68]

We can therefore conclude that Kant did not place complete trust in political authority, although he cannot be considered an anarchist. He connects freedom with Christian morality and argues that genuine freedom, sociality and respect for human dignity require recognition of a higher moral authority.[69]

Although Kant is a “philosopher of freedom,” he was also a man of strict discipline and moral principles.

For Kant, freedom cannot be separated from the moral law.

He emphasizes individual autonomy but does not neglect the social dimension of human existence.[71]

The Principles of Duty

Duty refers to behaviors that define our social role and that the individual is expected to demonstrate.[72]

Above all, however, Kant emphasizes principles of universal validity.

Among the statements attributed to or derived from his philosophical works are:

> “Religion is the recognition of our duties as divine commands.”[73]
>
> “Act only according to that maxim through which you can at the same time will that it become a universal law.”[74]
>
> “Nothing is divine except what is in accordance with reason.”[75]
>
> “Legally, a person is guilty when he violates the rights of others. Morally, he is guilty even when he merely thinks about doing so.”[76]
>
> “Man must be disciplined because by nature he is wild.”[77]
>
> “Morality is not the doctrine of how we are to make ourselves happy, but how we are to make ourselves worthy of happiness.”[78]
>
> “Enlightenment is man's emergence from his self-incurred immaturity, that is, his ability to decide for himself without the guidance of another.”[79]
>
> “Freedom is the value that contains all other values.”[80]
>
> “If a man makes himself into a worm, he should not complain when people step on him.”[81]

Other principles include:

> “A man can become whatever education has made him.”[82]
>
> “Dare to think; make use of your own understanding.”[83]
>
> “Do not use others merely as a means to achieve your own ends.”[84]
>
> “Never lie.”[85]
>
> “A free will and a will under moral laws are one and the same.”[86]

> “Two things fill the mind with ever new and increasing admiration and awe: the starry heavens above me and the moral law within me.”[87]
>
> “If we knew that God existed, morality would be impossible, because obedience motivated by fear of punishment or expectation of future reward would not be virtuous behavior but straightforward selfishness.”[88]
>
> “An action has moral worth only when it is performed from duty.”[89]

Kant's ethical theory does not condemn the human desire for happiness. Rather, he argues that the pursuit of happiness must remain within the boundaries of morality and that a person with a sound conscience should not judge actions solely according to their consequences.

Personally, I do not regard duty ethics as entirely separate from the virtue ethics discussed earlier in this chapter.

Rather, Kant and those who advocate deontology seek to establish a code of behavior. Without something resembling positive law, a supposedly “noble character” might claim the privilege of noble character or aristocratic birth to justify almost any action.[91]

This would create opportunities for the abuse of authority or exploitation.

1.4 Sympathy/Empathy (Adam Smith, David Hume)

We have already discussed Immanuel Kant.

At the same time that the European Enlightenment developed on the continent during the eighteenth century, a corresponding intellectual movement developed in Scotland: the **Scottish Enlightenment**.

British Enlightenment thinkers rejected arbitrary authority and believed in human equality. They regarded reason as an important means of reaching truth, but they differed from the continental Enlightenment through a stronger emphasis on **empiricism** and a greater role for emotion.

Whereas continental Enlightenment thinkers such as Kant emphasized reason, Scottish Enlightenment thinkers such as **David Hume, Adam Smith and Francis Hutcheson** placed greater emphasis on sentiment and emotion.

David Hume argued that morality is fundamentally a product of **sentiment rather than reason**.

Both Adam Smith and Hume were influenced by Francis Hutcheson.

Hutcheson believed that human beings possess an innate moral sense, a sense of honor and a sense of public or social feeling. He treated these as additional senses that belong naturally to human beings, much like our five basic senses.[92]

Hume and Smith built their moral philosophy upon this foundation.

Adam Smith wrote *The Theory of Moral Sentiments* in addition to *The Wealth of Nations*, the work for which he is much better known.

Smith is often regarded as the “father of economics” because *The Wealth of Nations* formulated important principles and laws of economics, including the concept of market equilibrium—the determination of equilibrium price and quantity at which the conflicting interests of producers and consumers are simultaneously satisfied.

Smith also addressed trade, the distribution of wealth, taxation, monetary questions and other economic issues.

David Hume similarly wrote about economic matters, including the balance of trade and a quantity theory of money that anticipated later monetarist ideas.

Adam Smith was a professor of moral philosophy at the University of Glasgow and simultaneously became known as the “father of economics.”

As a professor of moral philosophy, it would be difficult to imagine that he did not also develop a theory of morality.

There is no formally recognized “school of sympathy” in moral philosophy.[93] Nevertheless, I would like to examine sympathy separately and show how this Stoic concept, borrowed by Adam Smith from Stoic philosophy, relates to moral philosophy.

Because Adam Smith is regarded as the father of economics, this moral theory must be understood as an integral part of the economic system of the free market as envisioned by its original founders.

Stoic Sympathy

In Stoic philosophy, **sympathy** (*sympatheia*) is a principle of unity in the universe.

Everything in the universe is interconnected and affects everything else. The world is considered a unified, living and rational whole governed by the *Logos*, the divine rational order.[94]

What motivates the individual and connects them with other members of society and the wider world is an emotion that can be called **empathy or sympathy**.[95]

Sympathy becomes stronger or weaker depending on how close the other person is to us and how similar we are to them in character or more generally.

It is therefore natural for someone to experience the strongest sympathy toward members of their family, because they are closest to them and because the survival of the younger family member depends upon them.

We experience sympathy when something gives us life and antipathy when something threatens or removes it. Hence emotions of approval and disapproval, love and hatred.

These emotions function as mechanisms of survival for the individual.[96]

The ethical theory of sympathy therefore acts as a complement that both connects and differentiates the ethical theories examined so far.

Sympathy and Utilitarianism

Each individual, and all individuals collectively, is necessarily part of the world.

The survival of the individual depends upon society, and we experience pleasure when observing or participating in actions that benefit others.

According to Smith, two virtues are essential to a healthy society:

1. **Justice**
2. **Beneficence**

The survival of society cannot be secured in the absence of justice.

Beneficence is desirable but is not absolutely necessary for society's survival in the same way that justice is.

Justice exists when individuals do not harm others through their actions. It therefore corresponds to the avoidance of pain.

Beneficence is positive contribution—the pleasure produced through generosity or through providing material goods to other members of society, particularly those who are weaker or in need.

The individual is dependent upon society. Since individual survival depends upon the survival of society, actions that preserve society simultaneously preserve the individual.

We therefore experience sympathy—positive emotional responses—for actions that benefit society, even when personal interest is sacrificed.

The individual consequently has an internal need for justice and, secondarily, for approval of beneficence.

This need determines which behaviors we consider socially acceptable and worthy of approval and admiration and which we consider socially reprehensible and worthy of disapproval and contempt.

In this sense, the principle of utility operates at the level of society rather than merely at the level of the individual, sharing certain characteristics with utilitarianism.

Adam Smith was also fascinated by the Newtonian methodology of the natural sciences and sought to introduce similarly measurable principles into economics.

Sympathy and Deontology

The individual has a tendency to distinguish between behaviors worthy of approval and behaviors worthy of contempt or disapproval.

This happens spontaneously and does not necessarily require the imposition of a formal code of conduct or deontology, as Kant and other philosophers such as Rousseau propose.

The natural mechanism through which this occurs is the idea of the **impartial spectator**, the internal observer of our hearts.

The “impartial spectator” is an imaginary person whom, according to Adam Smith, we tend to construct in our imagination when judging the actions of others.

The impartial spectator is completely free from personal interest, passions and prejudices and is therefore able to judge as a neutral or fair third party.[98]

Smith explains that this mechanism functions as an internal conscience and operates spontaneously.

This internal conscience gradually leads individuals toward adopting social norms.

Smith's agents therefore appear to accept, silently and internally, Kant's categorical imperative and moral law without being externally constrained by a third body.

Sympathy and Virtue Ethics

The internal conscience and the impartial spectator suggest that Smith was concerned with the formation of a **virtuous character**.

Indeed, it is not accidental that in *The Theory of Moral Sentiments*, Part VI, entitled “Of the Character of Virtue,” Adam Smith begins with Aristotle and the ethical principle of the mean discussed earlier in Section 1.1.

Smith argues that states of excess and deficiency are worthy of contempt and disapproval by our internal spectator.

The difference from the ancient Greek philosophers discussed here is that they placed primary emphasis on reason and did not discuss the role of emotion, passion or experience in knowledge.

The difference from the philosophers of the European Enlightenment, who also emphasized reason, is that they formulated ethical theories based on the formal and strict character of a moral law and written rules.

By contrast, in the morality of the impartial spectator, these social rules are not written. They are unwritten and do not originate in the mind but in the heart.

This enhanced role assigned to emotion by the philosophers of the Scottish Enlightenment, in comparison with the almost exclusive emphasis on reason found in the European Enlightenment, is what distinguishes the **ethics of sympathy**.[99]

Adam Smith accepts the importance of virtues and character, as Aristotle does, but grounds morality not in eudaimonia and the mean, but in sympathy and the judgment of the impartial spectator.

It is therefore related to virtue ethics without being identical to it.

We could also call it an **ethics of sentiment**.

1.5 Advantages and Weaknesses of Each Approach for Economic Decisions

Each of the ethical schools examined in this chapter approaches morality from a different perspective.

If we combine them, we essentially arrive at a **golden mean**, and the search for this golden mean constitutes one of the central objectives of this book.

To find this balance, we must examine the advantages and disadvantages of each ethical school in relation to economic decisions and economic science.

After examining their strengths and weaknesses, we will attempt to synthesize them in order to formulate a new economic theory capable of being economically efficient while simultaneously promoting individual freedom and serving human beings.

Some of the issues discussed here will be revisited in Chapter 5, when we examine the philosophical meaning of profit, and in Chapter 9, when we discuss inequality and the responsibility of the market, including business responsibility, corporate social responsibility and the point at which inequality becomes morally unacceptable.

1. The School of Virtue

Among the advantages of virtue ethics is the **sustainability and stability** of an economic system that does not rely exclusively on the outcomes of a particular policy, as occurs within a free-market framework, but also considers intentions and the ethical consequences of policy.

Combining virtue ethics with the free market would produce a different result from combining methodological individualism and utilitarianism with the free market.

It could lead to a reassessment of concepts such as exploitation, inequality and property.

It could mean, for example, that the objective of **full employment** should take priority over the objective of low inflation.

It also reminds us that behind the numbers appearing in a balance sheet or balance of payments there are human beings, and that decisions should not be evaluated exclusively according to their consequences but also according to their social impact.

Social values therefore acquire a weight comparable to market values.

Under the dominant ethics of the free market, this is generally not the case because market values are assumed to contribute more decisively to social welfare.

This issue will be analyzed further in later chapters.

For example, in Chapter 9 we will examine the contribution of GDP to measuring the level of welfare of a society as well as some of the weaknesses of GDP as an indicator of social well-being.

Consider a balance-of-payments problem.

Different techniques may be used to address it, such as currency devaluation or internal austerity through reductions in wages and pensions.

Depending on the ethical framework adopted, different approaches may be preferred.

Historically, the free market has often been associated with sacrifices and austerity.[100]

Both sacrifice and austerity may be alternatives to taxation and redistribution of capital, because redistribution from the top downward may be considered economically inefficient when judged exclusively according to market values rather than social values.[101]

The argument in favor of virtue ethics is instead based on the harmony it can produce among people, lower levels of tension and conflict, and reduced exploitation—not necessarily on the economic performance of the system.

A moral system that reduces negative characteristics of human nature, such as ambition, narcissism and greed, might reduce certain economic incentives.

Nevertheless, reduced exploitation and greater satisfaction among different parties can strengthen stability and make the economic system less vulnerable to collapse.[102]

A second advantage is that virtue ethics focuses on cultivating a virtuous character rather than on the strict formalization of deontology and the rigid legal framework of positive law.

It may therefore encourage the flexibility required by a free market to function effectively.

The state may also benefit from such flexibility.

By contrast, a strict duty-based ethical framework could become excessively formalized and restrict the flexibility and freedom required by a free market.[103]

This could have negative consequences for investment, efficiency and productivity and could impose additional burdens on people's lives.

For this reason, an ethical system focused on virtuous character rather than a rigid legal framework may have significant advantages.

Weaknesses of Virtue Ethics

A major weakness of virtue ethics in relation to economics is the tension between **results and intentions**.

Virtue ethics gives priority to good character and therefore places considerable weight on intentions.

It is not an ethics based on the principle that “the end justifies the means.”

This can sometimes make economic efficiency more difficult to achieve.

A virtuous individual may find it more difficult to pursue economic objectives efficiently and effectively.[104]

Success in a market may require a profit-oriented mentality, self-interest, cost reduction and limits on the demands of workers or particular social groups.

Ethical barriers may sometimes have to be overcome in the pursuit of efficiency—something a virtuous character may not readily accept.

A second weakness is that cultivating a virtuous character can restrict negative characteristics of human nature such as antisocial behavior, selfishness, exploitation, self-love, the insatiable desire for money and power, and narcissism.

At the same time, however, restricting these negative forces may also remove the incentives that motivate people to act.

Consequently, virtue can have a negative economic impact.[105]

To illustrate the importance of these arguments, one can cite the familiar expression:

> "The road to hell is paved with good intentions."[106]

---

2. The School of Utilitarianism

Utilitarianism constitutes the dominant ethical school providing economics with methodological tools for designing and implementing a free-market system and, more broadly, for motivating workers within any type of market or economy.

The calculation and measurement of pleasure, happiness and pain are closely connected with profit and loss in the market and provide individuals with a basic incentive to act.

Utilitarianism also contributes to the **basic economic principle** and to other models used in economics, which we will examine in the next chapter, including cost-benefit analysis, risk-reward calculations and expected investment returns.[107]

These incentives are highly effective for individuals compared with coercion and excessive formalization through a code of conduct or corporate policy.

The individual needs to perceive the benefit or profit in order to undertake the effort associated with physical or intellectual work.

We cannot rely exclusively on altruism or on negative incentives such as fear of punishment for violating the law.

Profit, by contrast, is a positive incentive because it does not deprive individuals of happiness; it offers them something desirable.

Positive incentives can genuinely motivate individuals to act and, particularly, to increase efficiency and productivity.

Negative incentives may maintain a certain level of efficiency but offer fewer prospects for improvement.[108]

Second, utilitarianism is a **consequentialist** ethical theory and is therefore often identified with consequentialism itself.

Within consequentialism, individuals think in practical terms and are guided primarily by the consequences of their actions.

This can produce both positive and negative results and can therefore constitute an argument both for and against utilitarianism.

Human intentions cannot be directly observed and are therefore difficult to predict.

Furthermore, actions frequently produce unintended side effects or **externalities**—outcomes that were not part of the original intention.

This can occur because of inadequate information, poor planning or indifference toward the interests of others in comparison with personal interest.

When unethical behavior produces personal profit, there is a **moral hazard**, because individuals have an incentive to continue behaving in ways that harm society or violate the rights of others.[109]

The individual can generally observe the final consequences of actions.

The broader argument is that nature itself has made us consequentialists and then uses this consequentialist nature to achieve its own purposes.[110]

For example, we eat because consuming food produces pleasure, without consciously recognizing that the underlying purpose of nature is simply our survival.

Similarly, we may love a particular person because we experience familiarity and pleasure, while from nature's perspective the deeper function of these emotions is the continuation and preservation of life.

Pain and pleasure therefore function as instruments through which nature achieves its underlying purposes.

If pain and pleasure are indeed the dominant forces through which nature motivates individuals, then utilitarianism is not merely an ethical theory that happens to be useful.

It may be the only form of ethics compatible with the natural motivational structure of human beings.

This means that individuals can be effectively motivated in the market, whether they are consumers or producers.

For this reason, economics and its associated disciplines—management, marketing, finance, banking and others—adopt consequentialist ethics through models such as the basic economic principle and cost-benefit analysis.

Weaknesses of Utilitarianism

The usefulness of utilitarian ethics for economic efficiency and productivity requires, in addition to pain and pleasure, the combination with **methodological individualism**.[111]

Otherwise, utilitarianism could become an obstacle to maximizing real wealth.

The opposite of methodological individualism is **methodological holism**, which focuses on broader social groups such as classes, the state and institutions.

Utilitarianism places the comparison between pain and pleasure at the level of the total members of a social group rather than exclusively at the level of the individual.

This can become a weakness for economic prosperity because it may lead to rejecting inequality among a minority for the benefit of the majority, insofar as the objective is to maximize the utility of society as a whole.

Without the prospect of personal profit and higher income, however, the basic incentive for innovation, research, discovery and the creation of new products could disappear.

This could reduce the overall wealth of the economy and lead to job losses.

At the same time, redistribution of income from wealthy individuals toward the middle and lower classes could reduce the suffering caused by exploitation, extreme poverty, migration, homelessness, hunger and related problems.

There could therefore be significant non-monetary benefits that increase the welfare of the majority, but at the cost of lower economic performance.

This is why the same argument can constitute both an advantage and a disadvantage.

Economic decisions are not exclusively about increasing the real income of society; they can also concern the ranking of needs, distribution and other social objectives.[112]

Furthermore, when individuals are guided exclusively by the consequences of their actions, the balance and stability of an economy may be lost.

An economic cycle can emerge in which periods of growth and prosperity are followed by recession and stagnation of national income.

If we consider the long-term trend of GDP, abstracting from short-term fluctuations, real income could even exhibit a negative long-term trend.

---

3. The School of Deontology

Deontology shares many characteristics with virtue ethics.

For this reason, we will not repeat all the arguments already presented, such as the tension between intentions and consequences or the lack of flexibility associated with strict rule-based ethics.

The conflict between intentions and outcomes, especially when it takes the form of state intervention, is common at the level of the state and society and even more so within the economy.[113]

Consider the following example.

Suppose the state considers housing rents excessively high and intervenes by imposing rent controls below the market price.

The intention is to protect consumers from high rents.

Although lower rents benefit people looking for housing, they do not benefit property owners.

The lower regulated rents may discourage them from supplying housing to the market.

Reduced supply may eventually result in higher prices or even the emergence of a black market in which transactions occur without effective regulation and at even higher prices.

Thus, the original intention of reducing rents may ultimately lead to an even greater increase in rents.

Consider another economic example.

Suppose the economy is experiencing high inflation.

Imagine that the price of bread rises from €1.10 in the first quarter to €1.20 in the second quarter and eventually reaches €2.00 after one year.

This represents an increase of 81.81% relative to the initial price.

The government, observing the increase in prices, decides to impose a legal maximum price of €1.10 with the good intention of protecting lower-income households from inflation.

The result, however, may be that inexpensive bread is purchased rapidly by higher-income consumers who can afford it, producing shortages.

Consumers may then turn to substitute products that are even more expensive.

Thus, the original intention of helping those most affected by inflation may leave them in an even worse position.

This can also happen because of ambiguity in legislation or excessive legal complexity, which creates room for different interpretations.

The law may cease to express an objective reality and instead reflect the subjective interpretation that benefits the party applying it.

By contrast, under virtue ethics, utilitarianism or sympathy, there is not necessarily an equally rigid legislative framework through which the individual can be constrained and manipulated.

Excessive formalization and discipline can also reduce flexibility, make rapid decision-making more difficult and slow down the economy.

This may reduce competitiveness and make it harder for a country to attract foreign capital and income.

Deontology might nevertheless offer an advantage within a centrally planned economy or a large and complex organization, such as a multinational corporation.

In such organizations, the large number of participants can make rapid and effective decision-making difficult.

If every member acted entirely independently, the result could be chaos and indecision.

In such organizations, a formal code of ethics can serve as a guide to more effective decision-making.

4. The School of Sympathy

The ethics of sympathy is associated with the Scottish philosopher and father of economics **Adam Smith**, as well as **David Hume**, both of whom were influenced by Francis Hutcheson in the foundations of their moral philosophy.

Sympathy gives priority to emotion rather than reason and can therefore sometimes lead to incorrect or economically inefficient decisions.

This priority given to emotion over reason has led some scholars to associate Adam Smith with **behavioral economics**.[114]

Charity, beneficence and the promotion of socially desirable objectives can be understood as consequences of a virtuous ethics shaped by emotion.

From a strictly economic perspective, however, these activities might be regarded as a waste of corporate resources if the primary objective of a business is to maximize profit and offer competitive products to consumers.

Supporters of moral sentiment would respond that without emotion there are no desires, and without desires there is no meaningful role for reason.

Emotion is therefore an essential component of a free market.

Furthermore, for a free market to function successfully without requiring constant state intervention, transactions must be voluntary.

For a transaction to be voluntary, both parties must expect to benefit from it; otherwise they would not willingly participate.[115]

Mutual benefit and empathy are closely related.

Empathy or sympathy is the capacity of an individual to put themselves in the position of the other party and experience or understand their emotions.

This is why sympathy is an essential complement to a free market and why Adam Smith's reference to it is not accidental.

---

11. From this perspective, virtue ethics may be regarded as the appropriate ethical framework because it is the only form of morality fully compatible with a free market understood as a market without central planning or a government determining people's lives. This illustrates the importance of a work that combines economics and ethics: the dominant ethical framework in economics is consequentialism, because it is regarded as economically efficient. Under conditions of complete freedom, however, consequentialism may lead to anarchy or something resembling social Darwinism rather than equilibrium.

12. A virtuous character—that is, one possessing a sound conscience—may sometimes be justified in following conscience even against the state because the rules of positive law do not always express genuine moral laws (natural law) but may instead express class interests or the interests of particular social groups. Similar encouragements have been expressed in modern times by figures such as Albert Einstein and Martin Luther King.

13. This is consequentialism, which forms part of utilitarian ethics. Consequentialism is a purely practical logic that can develop into cynicism and, when adopted absolutely by an individual, can lead to a principle resembling “the end justifies the means.” This creates a Machiavellian rather than virtuous character. Consequentialism is nevertheless adopted by positive economics, and when it dominates normative economic models one-sidedly, it may constitute a principle incompatible with individual freedom.

14. There is therefore an element of empathy here. This is why I distinguish sympathy/empathy from Adam Smith's theory of moral sentiments. In that work, when discussing morality, Smith begins by referring to Aristotle and the principle of the mean in order to explain which behavior is socially acceptable and worthy of admiration and approval.

15. This quotation comes from Aristotle's *Nicomachean Ethics*. Here again we can indirectly see how the virtuous individual may stand above the law of the state. Immanuel Kant uses the term “law of God” in contrast with human law, that is, the law of the political community, in *Religion within the Boundaries of Mere Reason*. This cultural attitude can also be seen in Sophocles' *Antigone*, the ancient Greek tragedy probably first performed at the Great Dionysia in 441 BC.

16. Aristotle, *Nicomachean Ethics*.

17. Aristotle, *Politics*.

18. Aristotle, *Nicomachean Ethics*. Here Aristotle presents the autonomous individual as a desirable behavioral model and approaches the thought of German Idealist philosophers such as Immanuel Kant and Adam Weishaupt. My position, which I wish to emphasize in this book, is that all these views may constitute necessary complements to one another or may represent the same underlying idea from different perspectives.

19. Aristotle, *Nicomachean Ethics*, Book I.

20. Aristotle, *Politics*, Book I.

21. Aristotle, *Politics*.

22. The practical application of this model can be seen in the system of government associated with Alexander the Great.

23. Historically, Socrates preceded Plato and Plato preceded Aristotle. Each was the teacher of the next, who in turn became a student of the previous philosopher. Here, however, I begin in reverse order by presenting Aristotle first because he is the philosopher most closely associated with virtue ethics and, as the last student of the preceding philosophers, may have inherited the knowledge and experience of each. One reason Plato lost confidence in democracy was the way democratic Athens treated his teacher Socrates. Socrates was executed in democratic Athens in 399 BC after being convicted of impiety toward the city's gods and corrupting the youth. This experience clearly affected Plato.

24. This resembles the view that leaders are born rather than made—a view that dominated business and society for many years and was a remnant of an older, more conservative era characterized by stronger class distinctions.

25. Social Darwinism is an ideological and social theory of the nineteenth century that distorted Charles Darwin's biological ideas concerning “survival of the fittest” and incorrectly applied them to human society. It is not a science but an ideology. Its basic idea is that societies operate like nature, where the “strong” naturally prevail while the “weak” are considered inferior and therefore legitimately remain behind. It consequently regards assistance to the weak as contrary to “natural evolution.” Important representatives of social Darwinism included Herbert Spencer and Francis Galton, while Charles Darwin himself has sometimes been presented as a supporter. There is also an interesting relationship between social Darwinism, neoliberalism and the free market: they appear to share certain characteristics while also differing in important respects.

26. Plato's preference and broader political position led to criticism from thinkers such as the twentieth-century Austrian philosopher Karl Popper. In *The Open Society and Its Enemies*, Popper considers Plato—together with Karl Marx and Hegel—to be a defender of totalitarianism.

27. Plato, *Laws*. Some versions render this as: “Good men do not need laws to tell them to act responsibly, while bad men will find a way around the laws.”

28. This quotation is attributed by some to Plato, but it is more likely to have originated with Aristotle.

29. Plato, *Laws*, 728a–b.

30. Plato, *Euthyphro*, 10a–11b. This is a Platonic work and a dialogue involving Socrates. Because of this overlap, the two philosophers are often confused.

31. Plato, *Laws*.

32. Plato, *Apology of Socrates*.

33. Plato, *Apology of Socrates*.

34. Plato, *Meno*.

35. This statement is attributed to Socrates but appears to arise from the context of the two dialogues mentioned above rather than appearing verbatim in the work of any philosopher.

36. Plutarch, *Moralia*, specifically *On the Education of Children* (*De liberis educandis*).

37. In contrast, both Plato and Aristotle, although to a lesser extent in Aristotle's case, have been described as representatives of a "closed society" by twentieth-century philosopher Karl Popper in *The Open Society and Its Enemies*.

38. Plato, *Republic*, Book I. It is worth noting that Aristotle expressed a similar idea.

39. Plato, *Apology of Socrates*, 30b.

40. Epictetus, *Discourses*, Book II, 18. It is most likely incorrectly attributed to Socrates.

41. Plato, *Apology of Socrates* and *Crito*.

42. Plato, *Republic* and *Apology*.

43. Plato, *Apology of Socrates*.

44. Plato, *Apology of Socrates*. The statement does not appear exactly in this form but is attributed to Socrates, probably incorrectly. In the *Apology*, Socrates says that he serves God and truth rather than simply Athens or the Athenians.

45. Plato, *Republic*, Books I–III.

46. *Republic*, Books I–III and *Meno*.

47. *Republic*, Book I, and *Apology*.

48. *Republic*, Books I–III.

49. Plato, *Apology of Socrates* and *Crito*.

50. Plato, *Republic*, Book I, and *Apology of Socrates*.

51. Plato, *Euthyphro*, 10a–11b. A corresponding reference was also made in the discussion of Plato because of the confusion between Socrates and Plato. The dialogue is presented as a Socratic dialogue.

52. Karl Popper, *The Open Society and Its Enemies*.

53. Alternatively, the terms pleasure, suffering or happiness may be used.

54. The term *Homo Economicus* was developed and established during the nineteenth century, particularly through John Stuart Mill. In 1836, in *On the Definition of Political Economy*, Mill described human beings as rational beings who systematically seek to maximize their personal economic benefit. Although he did not always explicitly use the Latin expression, the concept was established at that time and was later named *Homo Economicus*. The term subsequently became widely used in economic theory to describe the simplified model of the human being as fully rational and self-interested.

55. John Stuart Mill, *On Liberty* (1859), Chapter I, “Introductory.” Translation by the author.

56. Anthony Downs, *An Economic Theory of Democracy.* Pareto optimality, or the Pareto optimum, is a concept in economic theory and welfare economics. A situation is Pareto optimal when the position of one person cannot be improved without worsening the position of another. In other words, all “costless” improvements have been exhausted. For example, if making one person richer necessarily makes another poorer, the situation is Pareto optimal.

57. At a later stage in his life, Mill appears to have adopted a belief in socialism with regard to production.

58. The position that the welfare of the majority should be maximized, together with the relative disregard for the interests of an oppressed minority or individual, appears to have been more pronounced in Jeremy Bentham's formulation of the idea than in that of John Stuart Mill.

59. Kant, Immanuel, *Groundwork of the Metaphysics of Morals*.

60. His view of and role assigned to religion are presented in *Religion within the Boundaries of Mere Reason*.

61. For example, the Ten Commandments received by Moses on Mount Sinai.

62. As a reminder concerning the noble lie, the reader may wish to return to subsection 1.1.

63. In *Religion within the Boundaries of Mere Reason*, Kant argues that the “noble lie” was essentially necessary in earlier periods when human beings were unable to understand and explain phenomena through reason. There was therefore a need for a divine being or similar “noble lie” to guide people toward virtue or explain natural phenomena. As humanity develops historically, however, it ought to abandon these supports once provided by religion and stand on its own feet. This is an argument developed in that work. We should also remember that Kant was an Enlightenment philosopher, and the Enlightenment sought to liberate human beings from the bonds of authority during the eighteenth century.

64. Kant, I., *Essays*, translated by Evangelos Papanoutsos, Dodoni Publications.

65. Kant refers to “unsocial sociability,” which constitutes a guiding thread of nature. In the same work, the German philosopher compares trees growing in a forest with isolated trees in order to demonstrate the benefits of competition in nature and among human beings. He goes so far as to argue that, through this mechanism, the wisdom of nature can lead even a population of devils toward the achievement of a good purpose.

66. This is discussed in *Religion within the Boundaries of Mere Reason*, while in *Idea for a Universal History with a Cosmopolitan Aim* Kant explains how nature uses humanity's innate unsociability as a guiding thread toward its own purposes, without individuals understanding those purposes. He uses the concept of “social unsociability,” which resembles the idea not that human nature is evil but that human beings possess a propensity toward evil.

67. This universal federation constitutes a preliminary stage or alternative to a global republican state. Although such a state might be desirable, it could also create the danger of totalitarian despotism. Republicanism essentially refers to representative democracy in which executive and legislative powers are separated. Kant discusses this in *Toward Perpetual Peace: A Philosophical Sketch*.

68. Kant, I., *Idea for a Universal History with a Cosmopolitan Aim* (1784).

69. In the essay *What Is Enlightenment?*, Kant states that human beings need a master and cannot trust themselves to find one through a defective human source characterized by a propensity toward sin.

70. John Rawls and Robert Nozick are considered successors and continuators of Kant in certain respects. Nozick wrote *Anarchy, State, and Utopia*.

71. Both strict discipline and autonomy reflect aspects of Kant's Protestant ethics. Autonomy means individual responsibility: the idea that one is one's own legislator.

72. Stella Sotiriou, Styliani Kordonouri and Aikaterini Zafranidou, *Social and Political Education, 3rd Grade of Gymnasium*, pp. 20–25.

73. Kant, I., *Religion within the Boundaries of Mere Reason* (1793).

74. Kant, I., *Groundwork of the Metaphysics of Morals* (1785).

75. Kant, I., *Religion within the Boundaries of Mere Reason* (1793).

76. Kant, I., *The Metaphysics of Morals* (1797).

77. Kant, I., *On Pedagogy* (1803).

78. Kant, I., *Critique of Practical Reason* (1788).

79. Kant, I., essay *What Is Enlightenment?* (1784).

80. Kant, I., *Critique of Practical Reason* (1788).

81. Kant, I., *The Metaphysics of Morals* (1797).

82. Kant, I., *On Pedagogy* (1803).

83. Kant, I., essay *What Is Enlightenment?* (1784).

84. Kant, I., *Critique of Practical Reason* (1788).

85. Kant, I., *The Metaphysics of Morals* (1797).

86. Kant, I., *Groundwork of the Metaphysics of Morals* (1785).

87. Kant, I., *Critique of Practical Reason* (1788).

88. Kant, I., *Critique of Practical Reason* (1788) and *The Metaphysics of Morals* (1797).

89. Kant, I., *Groundwork of the Metaphysics of Morals* (1785).

90. Kant, I., *Critique of Practical Reason* (1788) and *The Metaphysics of Morals* (1797). Here Kant argues that good should not be done for a particular ulterior purpose but from a sense of duty.

91. In the preface to the Greek edition of Immanuel Kant's *Essays*, translated by Papanoutsos and published by Dodoni, we read that virtue stands above all goals and that trust in the power of reason, particularly in its practical function, together with the need and expectation of a liberal and just state that will allow human beings to live peacefully and according to their moral purpose, constitute the two pillars of the Kantian system.

92. These additional three “senses” could perhaps be identified with the three parts of the soul described by Plato, from which the three social classes of the ideal state emerge: those who love virtue, those who love honor/glory, and those who love profit.

93. It is not therefore a classical ethical theory. This is also noted in the preface to the Greek edition of *The Theory of Moral Sentiments* by Professor of Moral Philosophy Dionysios Drosos.

94. Since we are all parts of the same universe, we ought to show solidarity, understanding and justice. The ethical way of life is based on living “according to nature” and the rational order of the universe. In simple terms, Stoic sympathy states that nothing is isolated: everything is interconnected within a rationally organized universe.

95. Consider that in English the word “emotion” contains the word “motion.” Emotion therefore provides the necessary motivation for the individual. Without it, reason alone cannot formulate an effective theory of motivation, including motivation for moral behavior.

96. Hence the concept of “familiarity,” which describes the pleasant emotion or pleasure that connects us with certain people. Empathy thus becomes part of what the German philosopher Schopenhauer calls the “Will to Life,” an invisible force guiding our actions in the universe.

97. Smith, Adam, *The Theory of Moral Sentiments* (1759).

98. For many scholars, Smith's impartial spectator also inspired John Rawls's later twentieth-century concept of the “veil of ignorance.” Rawls's moral and political thought will be examined in greater detail in Chapter 6.

99. David Hume, for example, states in *A Treatise of Human Nature*: “Reason is, and ought only to be, the slave of the passions, and can never pretend to any other office than to serve and obey them.”

100. Wendy Brown, *Undoing the Demos: Neoliberalism's Stealth Revolution* (2017).

101. By “market values” we mean measurable values such as accounting figures and financial accounts. Such measures can be identified either at the level of an individual business or at the level of a national economy—for example, debt-to-GDP, GDP itself or ROI (ROI = net profit / shareholders' equity).

By contrast, social values concern interest in others rather than personal interest and are much more difficult to measure and monitor than market values.

Examples of social values include beneficence, selfless contribution, voluntary work for socially desirable objectives and every form of self-sacrifice undertaken by individuals for the benefit of important causes affecting others.

Generally speaking, we might say that the state focuses more on social values, whereas private individuals focus more on market values.

102. One of the selfish incentives discussed here is profit. In Chapter 5 we will show how one-sided devotion to profit produces strong fluctuations in the business cycle and what this means both for economic performance and systemic stability. It could perhaps be argued that exclusive devotion to profit can have negative effects even on economic performance itself when examined over the long term.

103. Virtue should not, however, be identified exclusively with individual autonomy or with the strict paternalism of a centralized state. Aristotle and Plato were both associated with virtue ethics, yet Aristotle regarded Athens as the appropriate political model while Plato admired Sparta. Athens attempted to educate autonomous and free citizens, whereas Sparta relied more heavily on state control. Socrates also appears to have supported individualism. Virtue should therefore not necessarily be associated with absolute freedom. Nevertheless, because it focuses on character rather than rules, as deontology does, it can allow greater freedom and flexibility for individuals, which is essential for economic prosperity and success.

104. This is because success in a free market requires strong commitment to market values such as the pursuit of profit, which may conflict with Aristotle's principle of moderation.

105. To support this argument, I refer the reader to the philosophy of Bernard Mandeville. Mandeville was an Anglo-Dutch economist and philosopher. He is known for *The Fable of the Bees*, in which he argues that virtue does not necessarily produce positive economic results and therefore should not necessarily be encouraged. Private vices can be transformed into public benefits: without the “bad character” of human beings, society would not have professions such as police officers, locksmiths, merchants, entrepreneurs and other productive groups.

106. This expression is attributed by some to Seneca, the ancient Roman Stoic philosopher, and by others to Saint Bernard of Clairvaux, a French monk and theologian of the twelfth century.

107. The expected return on an investment equals the return associated with an outcome multiplied by the probability of achieving that outcome. Suppose an investment has two possible outcomes:

1. a 50% probability of gaining €100;
2. a 50% probability of losing €50.

The expected return is:

Expected Return = (0.5 × 100) + (0.5 × −50) = 50 − 25 = €25

This means that, on average, one expects to earn €25 from this investment over the long term.

108. Herzberg's Motivation Theory.

109. See Chapter 4 for a more detailed discussion.

110. For example, we eat because consuming food gives us pleasure, without consciously recognizing that nature's purpose is simply our survival. Similarly, we may experience feelings of love toward another person or toward another

living being because we experience familiarity and pleasure. From nature's perspective, however, the deeper purpose is the preservation and continuation of life. This is nature's underlying objective, while pain and pleasure are the instruments through which it is achieved.

111. In the social sciences, such as political economy, we focus on the actions and behavior of individuals rather than broader social groups.

CHAPTER 2

WHAT IS ECONOMICS? CONSTRAINTS, MODELS AND VALUES

2.1 The Basic Economic Problem

Human beings have certain needs by nature. These needs are unlimited and are not subject to permanent saturation; that is, they can only be satisfied temporarily and reappear later. We can obtain an idea of human needs from the well-known psychologist A. Maslow.[115]

Most of these needs require a productive process in order to be satisfied, that is, a process through which raw materials and factors of production are processed and transformed so that the goods we need to satisfy these needs can be created. These goods, insofar as they result from a productive process involving a combination of the factors of production, are called **“economic goods,”** in contrast to certain other goods that we find freely in nature and whose production does not require any physical or intellectual labor or effort. In economics, we focus on economic goods, which also constitute the majority of goods as a whole.

However, the factors of production, and therefore the goods that can be produced, are not unlimited. They are constrained by the resources we possess and by the capabilities of the economy. On the other hand, needs are unlimited and are not subject to permanent saturation; that is, they tend to reappear. This creates the **basic economic problem** of every society.

This problem arises from the **scarcity of goods**, that is, the shortage of goods that is the unavoidable consequence of the scarcity of the factors of production.[116] This problem is permanent and concerns every society, while it creates a series of additional economic problems that we will examine below.

Consequently, dealing with it, insofar as this is possible, is of vital importance—not only for satisfying people's immediate material needs, but also for applying an authentic ethical system that reflects genuine moral and social values rather than merely constituting a propaganda ideology intended to manipulate reality and the productive and economic model so that particular economic interests are satisfied.

Essentially, what I want to say is that there is little room for genuine moral values and ethical principles when human needs cannot be satisfied.

At this point, it is necessary to explain certain terms that we have already mentioned and with which the reader may not be familiar, since understanding them is necessary for defining the main economic problem.

Factors of production

Labor, land (or nature), capital and entrepreneurship.

Usually, the production of goods takes place through the productive process. That is, matter must be transformed in order to acquire a form that is useful to human beings. This is the productive process.

It takes place through the combination of human labor with nature. In other words, certain factors are combined in order for the productive process to take place.

First, **labor**: by labor we mean the expenditure of human effort, physical or intellectual, for the production of a product. For example, the worker who builds a house, the farmer who plows the land, or the teacher who teaches. All of them make an effort, which is why their activity is economic.

Second, **land or ground**: this factor includes geographical territory, the surface of the land, the subsoil, lakes, rivers, seas, plots of land, fields measured in stremmata, etc. It includes the land on which a factory or house is built, or on which various crops grow.

Third, **capital**: the factor of capital includes all products used in the productive process and used for producing other products. Here we mean, for example, machinery, buildings, installations, tools, etc. These are structures used to carry out the productive process, such as buildings or machinery.

It should also be stated at this point that we must distinguish **real capital** from **financial capital**, which is the amount of money from which these buildings are acquired. Financial capital may refer, for example, to the share capital contributed by entrepreneurs to a business and appearing on its balance sheet as part of its net worth. The purchase of buildings and machinery is financed from this source.

These are two different things.

The totality of knowledge and abilities acquired by a person through education and experience is called **human capital**.

A factor of production is considered such when it is utilized. For example, uncultivated land is potentially a factor of production. The same applies to labor and capital. For example, unemployed people constitute a potential labor factor because they are not being utilized in the economy.

We also refer to **entrepreneurship**.

By entrepreneurship we mean the ability possessed by certain people to recognize an opportunity for profit in particular activities and, having identified the profit opportunity, to assume the risk of combining the other three factors we have mentioned—labor, land and capital—in order for production to take place.

This is entrepreneurship. It is a distinct ability.

Many people, however, because they do not regard it as something separate, include it within the factor of labor and therefore do not consider it a separate factor of production. Others regard it as a different type of ability and consider it, in itself, to be a fourth factor of production.[117]

Needs

A guide to human needs is the **Maslow pyramid** that we mentioned earlier. At the base of the pyramid are biological needs and safety needs, that is, the human need for food, housing, future security regarding these goods, etc.

When a need is satisfied to a minimally acceptable degree, temporary saturation of that need occurs, and the individual then moves toward satisfying a different level of needs in Maslow's hierarchy.

Generally speaking, we could divide needs into two categories, and it is very important to distinguish between them and not generalize by attributing the same weight or importance to all needs. The problem of scarcity of goods means that, in practice, not all of our needs can be satisfied and some must be sacrificed.

Within this framework, a hierarchy of needs is necessary for rational choice and decision-making.[118]

The two categories are:

1. **Natural Needs or Survival Needs (needs)**
2. **Social Needs or Cultural Needs (wants)**

The latter could simply be called **desires**.

The first category concerns the human need for food, clothing and footwear, housing, etc., and we could identify these with the first two hierarchical levels of Maslow's pyramid, namely biological needs and safety needs.

Survival needs are imposed upon human beings by their very nature, and we can recognize them if we consider the common needs observed in human beings today in comparison with primitive human beings.

The second category concerns social or cultural needs, or simply desires. These are needs that did not initially exist but were historically created as human beings developed, created civilization and became concentrated in cities.

Such desires include desires for personal appearance, communication and information, and, more specifically, the desire for a larger car, holidays abroad, a better house, more expensive clothes, better education, a cleaner environment, etc.

Initially, these needs appear as needs of luxury or display and gradually, once the products become known and affordable to everyone, they evolve into ordinary social needs.[119]

This is due to the properties of needs to **evolve and multiply**.

When we say that needs evolve, we mean that new goods are created which satisfy pre-existing needs. For example, the need for transportation was initially satisfied through animals, later through carriages, and today through automobiles.

Similarly, human beings once satisfied their need for heating with fire, later with stoves—initially wood-burning, then gas or electric—and in the modern era with radiators or air-conditioning units.

Another property of needs is their **multiplication**.

The multiplication of needs means the creation of new needs. In other words, needs multiply: new needs are created that did not previously exist.

For example, the need for mobile phones did not exist a few years ago, whereas today most people possess such devices. Similarly, the need for a television set did not exist for the Greek consumer before 1965.

The evolution and multiplication of needs are also due to certain factors. Such factors include, for example:

- technology,
- imitation,
- habit,
- advertising.

Technology results in the discovery of new products. These new products either satisfy existing needs more effectively—for example, the digital camera or the DVD—or create new needs, such as the personal computer.

Imitation concerns the innate tendency of human beings to imitate others and contributes to the creation of new needs. This evolves and multiplies our needs.

For example, the exchange of gifts on February 14 is the result of imitating a custom from another country. Similarly, the consumption of Christmas trees during the Christmas period is the result of imitating a custom from another country. Traditionally, Greeks decorated a small boat.

Third, there is **habit**, that is, the tendency to repeat a pleasure, which can develop and create new needs. Smoking is an example. We often hear the expression, “He got used to it and it became a need.”

And fourth—and, I would say, decisively—there is **advertising**, which acts psychologically and creates a desire to acquire goods: a desire that otherwise would not have existed.

The enormous development of mass media, and especially television, gave advertising the ability to approach consumers regardless of their age and to “impose” new products upon them, increasing their needs and leading them toward overconsumption.

These are some of the factors that contribute to the evolution and multiplication of needs.

We see how, with the progress of civilization, more needs are created, particularly social needs. Social needs, or cultural needs, or desires, are unlimited and constantly increasing.[120]

From these properties of needs, and from their distinction into needs and desires, we understand that not all needs have the same weight. Consequently, they must be ranked and priority must be given to the most important and urgent needs, such as biological needs.

Thus, certain tools, models, assumptions and a specific methodology were created to help us make decisions and organize an economy in the best possible way.

In addition, four questions arise from the basic economic problem, which every economic system must answer. The different way in which each economic system approaches these issues constitutes the criterion by which we characterize a system as capitalist or socialist/communist.

These questions essentially constitute the subject matter of **political economy**:

1. **What products are produced and in what quantities?** — within a given period of time.
2. **How are they produced?**
3. **For whom are they produced?** — that is, how are they distributed among the members of society?

4. **How will the economy develop?**

For example, productive resources must be used for the construction of schools, roads and housing, for the education of more doctors, for defense, and for environmental protection.

An economy may place emphasis on the healthcare system, quality education, the entertainment industry, the music industry, sports, etc.

This distinguishes, for example, a free market from a centrally planned economy.

Another important difference concerns the way in which goods are produced. How should available productive resources be combined in order to achieve the greatest possible result, given that the factors of production can be organized in many different ways to produce the same goods?

For example, a small manufacturing business may package nuts using 20 workers in one day or two workers and an automatic packaging machine in one hour.[121]

Depending on the culture that characterizes an economy or its market and businesses, or more broadly its population, these issues are approached differently.

The first case, for example, would be chosen by an economy that wants to preserve jobs and maintain a low unemployment rate in its labor force, at the cost, however, of more difficult production and supply of goods, a less competitive economy, and the greater physical and intellectual effort associated with more labor.

By contrast, the second case concerns economies that, by making use of modern technology, manage to limit unnecessary labor and produce a larger quantity of goods on a mass scale and more competitively, thereby giving more categories of the population access to those goods.

In the first case, the increased cost of employing 20 workers rather than two would mean an increase in the price of the good produced, resulting in the exclusion of lower-income groups from the market for that good.

Third, **for whom will the product be produced?**

That is, how will the product be distributed? Should distribution proceed from the top down or from the bottom up? How much inequality of income is acceptable?

Is an economic system based on equality of incomes fair or unfair?

The first case is more commonly found in communist economic systems, which attempt in this way to eliminate extreme poverty and the injustice arising from large inequalities.

By contrast, the second approach is usually found in Western capitalist free-market economies, which provide greater moral justification for income inequality because in this way the more productive or harder-working individual is rewarded, and inequality generally constitutes a necessary incentive for professionals to enter certain fields.

This inequality therefore constitutes a lever for economic development, with the result that the position of everyone in the economy improves, including those with the lowest incomes.

Finally, there is the question of **how the economy will develop in the future**.

This problem concerns decisions and forecasts relating to the future, the formulation of budgets and strategic decisions. These are either made centrally, when we are dealing with a centrally planned economic system, or by the boards of directors and management of companies and industries in a free-market system, in which decisions are decentralized and made by private individuals who own the productive units of the economy.

Such strategic decisions may concern which investments will be made, how infrastructure will be improved or developed, because this is a decisive factor in attracting wealth; how an economy will attract capital or new technology; how it will develop alternative sources of revenue and diversify its services so that it is not vulnerable to future changes in the broader environment; whether it will invest in universities or defense programs; whether it will attract new labor; how it will combat corruption; how it will improve the political system, etc.

In order to provide answers both to the basic economic problem and to the individual questions arising from it, a series of tools, techniques, decision-making methods, etc. are developed, which we will examine in Section 2.3.

For the moment, we can say that the problem of scarcity of the factors of production—that is, the basic economic problem—can be addressed, or its effects mitigated, in the following ways:

1. **Achieving full employment and an optimal allocation of the means of production**, so that human resources are fully utilized and there is no waste of labor or other productive resources.
2. **Utilizing and continuously improving technology**, which improves productivity and the competitiveness of the economy, thereby giving even the weaker members of society an opportunity to acquire a share of the market's output. At the same time, it encourages the discovery of new productive resources.[122]
3. **Better organization of the production process and application of worker-incentive techniques**, in order to improve efficiency and minimize the waste of resources, such as time.
4. **Fair distribution of the social product produced.**[123]
5. **Investment in the future development of the economy.**
6. **Improvement of the justice system**, in order to eliminate corruption and profiteering and create conditions of security against criminal or terrorist acts, which are prerequisites for successful investment while simultaneously allowing people to work without distraction, since they do not have to fear for their personal property.[124]

Addressing the basic economic problem is one of the most important purposes of our existence, and we should work toward this objective by setting long-term goals and delivering a better future to subsequent generations and, historically, to humanity.

Unfortunately, however, there are phenomena or events that make the economic problem more intense. Such factors include:

1. The continuous increase in population.
2. The squandering of available resources in destructive wars.
3. The depletion of certain sources of raw materials and energy, e.g. oil.
4. The lack of capital and modern technology.

All of the above factors, combined with the effort to satisfy needs, burden the environment and contribute to the excessive use of non-renewable resources and the worsening of the basic economic problem.[125]

We will return to this subject and examine the tools and techniques used by positive economics in dealing with the problems we have mentioned. First, however, we must distinguish between positive and normative economics and examine what the proper relationship between them should be.

This book, by combining ethics and economics, moves within both fields and, I would say, draws its means and methodology from positive economics in order to formulate a normative economic theory.

2.2 Economics as a Science: Positive vs. Normative Approach

We hear statements such as **“Economics is not a science.”** What characteristics of economic theory support this view?

Although economics adopts the methodology of the natural sciences and is governed by laws, in essence it is a social science similar to political science, sociology, psychology, etc.

This part of political economy concerns what we call **“normative economic theory/science,”** whereas the purely technical part, which concerns determining and finding prices or computational data, is called **“positive economics.”**

These two different aspects of economics are not, in reality, completely independent of one another. Each serves its own purpose, and together they cooperate in the formation of an economic system,[126] with positive economics providing the “evidence” upon which the arguments contained in a normative economic theory are based.

This becomes clearer if we consider some examples.

Positive Economics

It includes theorems and laws through which we can calculate numerical data in an economy or at the level of a business.

For example, the relationship between labor productivity and an increase in the labor factor constitutes the **Law of Diminishing or Non-Proportional Returns**.

This law tells us that as we increase the quantity of a factor of production—for example, labor—the quantity of the good produced initially increases at increasingly higher rates, but after a certain point it begins to decrease.

This applies as long as a business or an economy is unable to alter all factors of production simultaneously; that is, fixed and variable factors coexist.[129]

For example, we may have an unlimited number of workers, but not unlimited machinery, land or offices, and this creates the problem.[127]

Ποσότητα Εδάφους	Αριθμός εργατών (L)	Συνολικό προϊόν (TP ή Q)	Μέσο προϊόν (AP = Q/L)
10	0	0	–
10	1	5	5,0
10	2	12	6,0
10	3	22	7,3
10	4	36	9,0
10	5	50	10,0
10	6	60	10,0
10	7	66	9,4
10	8	64	8,0
10	9	56	6,2

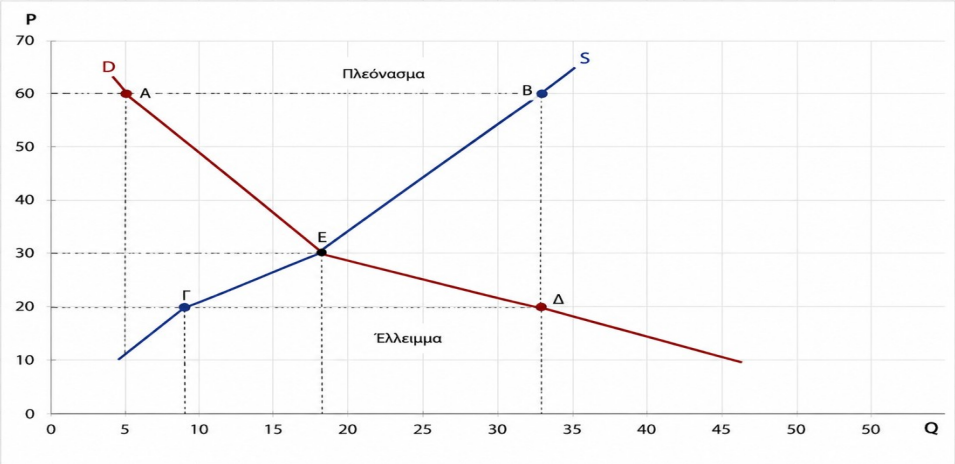
We can observe these data through the tables that follow.

We can observe from the data in the table that, firstly, the quantity of land is fixed, while the variable factor of production is the number of workers. Therefore, the conditions are present for the emergence of the Law of Diminishing Returns (or the Law of Diminishing Marginal Returns). Initially, as the number of workers involved in the production process increases,

3

total product increases at a more-than-proportionate rate. As a result, productivity (Average Product) follows an increasing trend. This upward trend continues until the addition of the fifth worker and remains at the same level with the addition of the sixth worker. Subsequently, with each additional unit of the labour factor added to the production process, productivity decreases. This is due to the relatively low rate of increase in total product that we observe.

Another example is the calculation of the equilibrium price and quantity in a market, as well as the calculation of the quantities of the product and their corresponding monetary values (that is, total revenue or total expenditure, profits, and losses). This is achieved through the supply and demand curves and the calculation of the corresponding quantities.



We can observe from the diagram that a market for a good can be in equilibrium at a specific price, or it can experience a shortage or a surplus depending on whether prices differ from the level that our theoretical model considers to be the optimal level. At a price of €30, we have equilibrium, meaning that there is no difference between the quantity demanded and the quantity supplied (i.e., quantity demanded = quantity supplied) at 20 units of the product. This means that, at this price, sellers are willing to sell 20 units and buyers are willing to purchase 20 units. This is the equilibrium price at which each side maximizes its benefit: producers maximize their profits, while consumers maximize the utility derived from the particular transaction, while at the same time limiting their overall expenditure. In a competitive market, sellers have no incentive to increase the price further, and therefore consumers are not faced with any additional burden.**[130]**

In order to understand this, we should first introduce the concepts of the market, as well as the demand for and supply of goods. A market is the environment in which purchases, sales, and transactions take place between sellers and consumers (or between businesses when referring to the wholesale market). It is therefore associated with the means and relevant places through which transactions take place, such as online marketplaces, the streets where a city's commercial

establishments are located, etc. The term may also be used in reference to the object of the transactions, for example, the real estate market.

As mentioned above, there are two sides participating in transactions in a market. Consumers seek to purchase goods at the lowest possible price, while sellers seek to sell them at the highest possible price.[131] Therefore, there is a conflict of interests, and a price must be found that satisfies the interests of both consumers and producers. This is essentially achieved through a process of negotiation, which may take place either implicitly or more actively through the voluntary decisions of consumers to purchase or not to purchase, and of sellers to offer or not to offer a certain quantity of goods at a given price. This price is the equilibrium price, through which the interests of the two sides are brought into balance.[132]

We observe that the quantity of land is fixed and that the variable factor of production is the number of workers. Therefore, the conditions for the appearance of the Law of Diminishing or Non-Proportional Returns exist.

Initially, as the number of workers in the productive process increases, total product increases at a disproportionately increasing rate. Consequently, productivity, or average product, tends to increase.

This upward trend continues until the addition of the fifth worker and remains at the same level with the addition of the sixth worker.

After that, with every additional unit of labor added to the productive process, productivity decreases. This is due to the relatively low rate of increase in total product that we observe.

Another example is the calculation of the **equilibrium price and quantity** in a market, as well as the calculation of the quantities of the product and their monetary equivalents—that is, total revenue or total expenditure, profits and losses.

This is done through supply and demand curves and the calculation of the corresponding quantities.

At this point, the text proceeds to the mathematical example of the equilibrium price and quantity, which continues through the following pages. The original equations are retained rather than reformulated.

Positive Economics — Mathematical Example

The behavior of consumers and producers in the market can also be expressed mathematically through the following formulas:

$Qd = \alpha + \beta P$
(where $\beta < 0$, expressing the law of demand)

$Qs = \gamma + \delta P$
($\delta > 0$ because it expresses the law of supply)

By equating these two quantities, we can find the equilibrium price and quantity, as well as the deviation between quantity demanded and quantity supplied in each case and therefore calculate the shortage or surplus appearing in the market under specific conditions, such as weak competition, legally imposed prices, etc.

Let us look at an example.

Suppose, for simplicity, that the demand and supply functions are linear. Graphically, this means that the demand and supply curves are straight lines.

As we know, the demand function is:

$$\mathbf{Qd = \alpha + \beta P}$$

and the supply function is:

$$\mathbf{Qs = \gamma + \delta P}$$

Since demand and supply are equalized at the equilibrium price:

$$\mathbf{Qd = Qs}$$

or:

$$\mathbf{\alpha + \beta P = \gamma + \delta P}$$

By solving this equation for **P**, we can calculate the equilibrium price, say $\mathbf{P_0}$.

If we substitute the price $\mathbf{P_0}$ into the demand or supply function, we will find the equilibrium quantity, say $\mathbf{Q_0}$.

If:

$$\mathbf{Qd = 280 - 2P}$$

and

$$\mathbf{Qs = 100 + 1.6P}$$

then, setting Qd = Qs, we find the equilibrium price:

$$\mathbf{100 + 1.6P = 280 - 2P}$$

$$\mathbf{3.6P = 180}$$

$$\mathbf{P_0 = 50}$$

If we substitute the equilibrium price into either the demand or supply function, we find the equilibrium quantity:

$$\mathbf{Qd = 280 - 2 \cdot 50}$$

$$\mathbf{Qd = 180}$$

and:

$$\mathbf{Qs = 100 + 1.6 \cdot 50}$$

Qs = 180

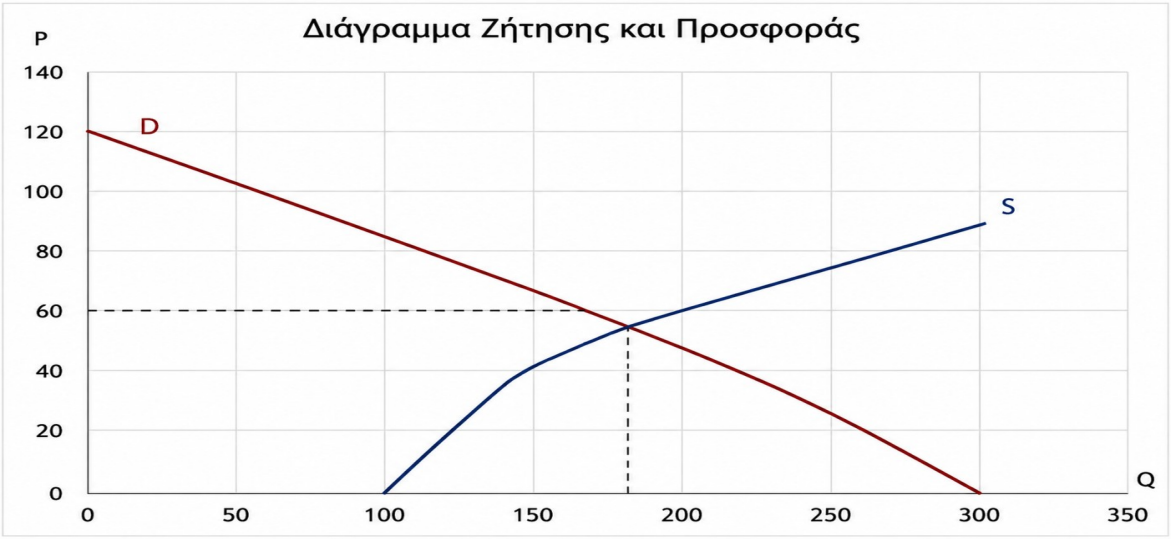
Therefore:

Q_0 = 180

and:

P_0 = 50.

The graphical representation of the above can be seen in the diagram that follows:



Through these examples we have seen two of the laws of economics:

1. **The Laws of Demand and Supply**
2. **The Law of Diminishing or Non-Proportional Returns in the Production Process**

Corresponding examples of many other laws can be found by consulting other microeconomics or macroeconomics textbooks. We will not expand excessively here, however, because the purpose is simply for the reader to understand the general content and the difference between the two, and this book is not a textbook of economic analysis.

Fields belonging primarily to positive economics include, indicatively:

- **Microeconomic theory** — consumer behavior, firms, markets
- **Macroeconomic theory** — GDP, unemployment, inflation, economic cycles
- **Econometrics**
- **Statistics for economists**
- **Game theory**

Example of a positive statement

> **“An increase in the minimum wage leads to a reduction in employment among young people.”**

Positive economics is therefore **descriptive of the world**. It describes real events objectively, based on observed experience and logic.

By contrast, **normative economics** is neither empirical nor descriptive of the world. It deals with the question **"how should things be?"** or **"what should be done?"**, rather than **"how are things?"**

It includes social values, subjective judgments and policy proposals.

The two methodologies, although apparently opposed and different, are in reality necessary complements to one another. It would make no sense to formulate a normative economic theory if it could not be realistically applied to the real world.

Consequently, normative economics may incorporate the logic supported by the models of positive economics on the basis of empirical analysis—for example, the spontaneous behavior of economic units in the market or characteristics of a phase of the economic cycle.

Example of a normative statement

"The state should increase the minimum wage in order to reduce poverty."

Fields belonging primarily to normative economics include:

- **Economic policy**
- **Public economics** — normative aspect, e.g. which tax system is "fair"
- **Ethics and philosophy of economics**

Finance Management

POSITIVE vs NORMATIVE ECONOMICS

Basiss	Positive Economics	Normative Economics
Meaning	Based on actual data, facts, and numbers.	Based on opinion & value of the interpreter.
Verification	Results can be verified.	Verification isn't possible.
Application	Safe & beyond doubt & can be proved scientifically.	No way to test feasibility & applicability in various field
Scope of result	Results & statements are descriptive & objective.	Results & statements are prescriptive & subjective.
Approach to problems	Doesn't intend to solve any problems of economy.	It strives to find solutions to problems.

Before moving on to the next section and examining some of the methodological tools of positive economics that help us manage the basic economic problem, the author pauses on the third field of

normative economics mentioned above: **Ethics and Philosophy of Economics**, which is also the field to which this book belongs.

It deals with questions such as:

- What is fair in the economic distribution of resources?
- What is the purpose of economic growth?
- Is the market ethically neutral?
- What are the limits of profit?
- How are freedom, equality and efficiency connected?
- What is the ethical responsibility of the state, businesses and economists?

It is closely connected with:

- political philosophy,
- social justice,
- philosophy of science,
- welfare economics.

This is the field which, through normative economic theories and policy proposals, attempts to provide solutions to problems.

Through the ideologies that develop, economists have the ability to shape consciousness and the world.[135]

Such ideologies include, for example:

1. Classical liberalism
2. Social liberalism
3. Socialism
4. Communism
5. Anarcho-capitalism
6. Neoliberalism
7. Economic nationalism

The list, naturally, is not exhaustive.

Some well-known works and authors belonging to this category include:

Adam Smith

1. *The Theory of Moral Sentiments*
2. *The Wealth of Nations*

John Stuart Mill

1. *Utilitarianism*
2. *Principles of Political Economy*

Karl Marx

1. *Capital*
2. *The Communist Manifesto*

Friedrich Hayek

1. *The Constitution of Liberty*
2. *The Road to Serfdom*

Milton Friedman

1. *Capitalism and Freedom*
2. *Free to Choose*

John Rawls

1. *A Theory of Justice*

Robert Nozick

1. *Anarchy, State, and Utopia*

John Maynard Keynes

1. *The General Theory of Employment, Interest and Money*

Anthony Downs

1. *An Economic Theory of Democracy*

James Buchanan

1. *The Limits of Liberty: Between Anarchy and Leviathan*

The list is not exhaustive, either with respect to the names or works mentioned, nor with respect to every specific economist-author included here.

Nevertheless, the work of all of them is important and operates complementarily with the others, as well as with this book, and together each contributes a piece to the puzzle of truth.[136]

2.3 Embedded Values: Efficiency, Rationality, Maximization

In Section 2.1 we discussed the basic economic problem and saw how it can be addressed. One of the arguments we examined was the optimal allocation of the means of production, in order to make the best possible use of them, since resources are scarce and we cannot have unlimited economic resources at our disposal.

We also saw that the problem can be addressed through better organization of labor or through the application of incentive systems that result in improved worker performance.

We therefore understand that there are certain concepts and methodological tools that are vital for the design and formulation, as well as the sustainability, of an effective economic system and for achieving our objective in the best possible way: **the utilization of the factors of production in order to satisfy human needs.**

Such concepts include:

- **efficiency**
- **rationality**
- **utility maximization**

From these values arise, indirectly, certain other principles, such as that of **Homo Economicus**: the model of the human being who seeks to maximize his utility as a consumer and maximize his profit as a producer.

Such a consumer or producer is considered **rational**, and his behavior is considered rational.

This is an assumption that we make in economics and an absolutely necessary generalization within a social science, in order to simplify complex reality and avoid becoming lost in the chaos of diversity that characterizes it.

In this way, we can draw conclusions and interpret society within the framework of a social science.

The assumption of **Homo Economicus** combines the ethics of utilitarianism with methodological individualism and thus forms the dominant model of economics.

Although this model is adopted as a working assumption in economics, as well as in other sciences such as political science, sociology, etc., it should nevertheless not be regarded as the absolutely desirable model of behavior and should be subject to limits.

We will examine this issue in greater detail in Section 2.5.

For the moment, it is worth saying that this is a **methodological device** that helps us achieve the objectives of efficiency and rationality and simplify complex reality so that a social science becomes possible.

At this point, it is important to examine the concepts mentioned above, beginning with **efficiency**, followed by **rationality** and **maximization**.

Efficiency

Efficiency measures the degree to which the objectives established during planning are achieved in a business or organization, or by the state when exercising its economic policy.

In other words, the results achieved are compared with the results intended.

It is usually measured as a percentage, e.g. a 70% increase in sales or a 15% reduction in production costs.

For example, if a business sets as its objective a **30% increase in sales** for the following year and ultimately achieves an increase of **10%**, its degree of efficiency is **33.33% (10/30)**.

Apart from percentages, absolute values can also be used.

For example, if a business sets as its objective an increase in sales of **1,000 units** and achieves an increase of **800 units**, its degree of efficiency is **80%**.

Thus the success rate of a business can also be calculated.

More simply, the formula that can be used for the degree of efficiency of a business is:

Efficiency = Achieved Units / Intended Units[137]

Rationality

This refers to the behavioral model that contributes to achieving the greatest possible efficiency—the behavioral pattern of **Homo Economicus**.

We assume that there is **perfect knowledge**, meaning that all economic agents—for example, businesses, households and individuals—know all the data and prices in a market and are capable of applying the basic economic principle: achieving the greatest possible profit at the lowest possible cost.

2.4 Forms of Market

According to Adam Smith:

“Man is the only species that makes exchanges.”[143]

Almost from the beginning of human history, human beings have had a tendency to engage in exchanges with one another in order to satisfy their needs. Nature did not give us either the claws of a predator or the strength and speed of a horse or lion to satisfy our needs; the only things it provides us with are human reason[144] and emotion. This means that we are destined, for our common good, to create structures and systems that will allow us to increase production, improve technology, and satisfy our needs. The fundamental motive that acts as the driving force behind this activity is our innate tendency to seek greater pleasure and avoid pain. The motive for achieving cooperation is emotion, while reason enables the creation of complex systems. At the same time, our innate tendency to seek pleasure at a personal level, often through a form of competition, constitutes the basic motive that drives human beings to create economic goods, thereby contributing, even without this being their original intention, to the maximization of social welfare. Therefore, human beings exist in a relationship of both interdependence and competition with one another. These two characteristics constitute the “wheels” upon which the “vehicle” of human survival rests.[145]

Initially, exchanges were limited to goods, that is, one thing in exchange for another. This system is known as barter. Under this system, each individual or household produced the goods that were necessary for them and attempted to satisfy the needs of its members independently, without significant cooperation, except at the level of exchanging goods between people. However, we can understand that this system had several problems, since there had to be a double coincidence of wants for two parties to participate voluntarily in the exchange of goods. In addition, it was not easy to transport all kinds of goods, nor could a good always be divided into smaller parts. For example, it is not possible to exchange five kilograms of potatoes for half a chair. There therefore had to be a way of establishing a commonly accepted medium of exchange that could overcome these deficiencies, and this medium is money.

There have been various forms of money throughout history. Various commodities and goods have been used as money, such as shells, stones, sand, cigarettes, etc. However, the commodity that possessed all the necessary characteristics required for a commodity to perform the function of money was gold. Gold is not perishable, can easily be reshaped, and can exist in both large units and smaller subdivisions, as required by a system of exchange. It is also relatively easy to transport, exists in relatively limited quantities, and is not easy to find or supply. This gives it the characteristic of scarcity, from which its value also derives.[146] This is also the reason why it has been called “the money of God”.

As long as the systems of barter and self-sufficiency[147] prevailed, the standard of living of humanity was particularly low, as was its real wealth. This is why the creation and development of money subsequently took place. However, I will not focus extensively on this aspect here. What I would like to focus on is the environment in which these exchanges, initially of goods and subsequently through the use of money, take place.[148]

This environment is the market. The market is associated with the relevant means and places where transactions take place. For example, these may be the commercial streets where shops are located in a city or open-air markets. In terms of the means through which transactions take place,

these may include telephone purchases, online purchases, etc. The term market is also frequently associated with the good that is the object of the transactions, such as the real estate market, the stock market, the foreign exchange market, etc.[149] Within the market, the two sides of the demand for and supply of goods come together. Consumers wish to purchase at the lowest possible price, while sellers wish to sell at the highest possible price. This conflict of interests is balanced through a process of "negotiation", which is explicit in some markets and informal in others.

What we call "equilibrium" in a market is referred to as "equality" in a socialist, centrally planned economy. A free market is essentially an attempt to achieve the same objective through different means. Someone who is genuinely liberal does not believe that the end justifies the means, at least with regard to achieving equality and enforcing rules. In other words, people are capable of exercising individual responsibility and fulfilling their duties without requiring state intervention to achieve this. This undertaking may not always be as effective as government intervention; nevertheless, it represents an honest attempt on the part of liberalism to place the ethical principles of freedom, individuality, autonomy, and independence above the oppression and restriction caused by the intervention of a powerful institution of authority, such as the state.[150]

How, however, can a natural state of freedom ensure the order and discipline achieved by the state through the exercise of its authority? How can it ensure the fair distribution of resources and the achievement of socially desirable objectives without the use of coercive power? Can the equilibrium generated by a price mechanism be as effective as the equality achieved through direct redistribution by means of taxation, fines, and increased public spending and debt? What corresponds to the "force of coercion" under conditions of political, economic, and civil freedom is the ethics of virtue[151] and competition![152]

Competition creates conditions of order, peace, and equilibrium within society and humanity, but it also appears to have a positive economic impact, since it "pressures" all parties to take an interest in the interests of others, to increase their productivity in order to become more competitive and, in this way, to "win" in this struggle for survival![153] Within the market, transactions are often not mutually beneficial and exploitation may occur, since, as we have shown, two competing interests meet in the market: sellers want to sell at a high price, while consumers want to buy at a low price. There must therefore be a balance of power between these competing interests, that is, something approaching the ideal of equality or minimizing inequalities, since absolute equality would be almost as destructive as the animalistic inequality that exists in our world today.

A fair distribution of income is achieved when transactions take place at what is known as the natural price of commodities: the price that provides sufficient revenue to remunerate labour, the factor of entrepreneurship, that is, the profit derived from the stock or business capital, and capital itself for their contribution to the production process, but no more than that. This price may either be established legislatively by the state or emerge spontaneously through a free market. We could therefore speak of two types of prices: the market price and the natural price. The two may often coincide or diverge.[154] One way of achieving this fair natural price is, as mentioned above, to establish it through legislation. However, this is not so easy to achieve, since the market price constitutes the link between supply and demand. In order for a legally established price imposed by the government to survive and remain stable, the appropriate market conditions must also exist; that is, demand and supply must be at levels that society and the state consider appropriate for satisfying both sides, buyers and sellers, precisely in the middle. In other words, a 50–50 relationship.

If these conditions do not exist, this fixed price, whether it concerns the exchange rate of a currency, a stock, or a commodity, will not survive. For example, if the price of a good is €30 and

consumers' disposable income increases by €1,000, but there is no corresponding increase in the quantity of real wealth represented by the goods of an economy, then a shortage will emerge in the market at the price of €30. Therefore, this (market) price does not bring equilibrium to the market and should increase, thereby giving the entrepreneurial and capitalist classes the opportunity to appropriate the surplus value![155]

In order for the state to manipulate market conditions, its powers and its ability to intervene and tax citizens would have to be increased. Such a development would constitute a threat to individual rights and freedoms. In practice, we also see that it often fails to produce the results we would like, since individuals tend to seek to avoid paying in order to fulfil their obligations towards society. At an even broader level, nations demonstrate a similar indifference to the interests of humanity and are unwilling to pay in order to help people and countries facing the problem of hunger. We will examine the issue of taxation, redistribution, and the phenomena of tax evasion and tax avoidance in greater detail in Chapter 8. For the time being, it is sufficient to say briefly that the choice of state intervention and a legally established price is neither effective nor sustainable.

The second case is the alternative solution of a completely free market, that is, laissez-faire capitalism. In this case, the market price fluctuates according to supply and demand in the market and may coincide with or diverge from the natural price. If we have:

Market Price = Natural Price under conditions of freedom

then the market is both fair and sustainable.

If, however, we have:

Market Price > Natural Price

then the economy is not fair, since the phenomenon of surplus value appears. That is, the labour effort is appropriated by the entrepreneurial or capitalist class, whose revenues increase far more than what they are actually entitled to receive based on the intellectual labour and risk they undertook and for which they legitimately deserve a share of the profit. In this case, justice is absent; however, the survival of the economy and the market is ensured, since the forces of supply and demand are in equilibrium and shortages of products do not arise in the market. This means that there are no unmet human needs.

However, the greater the difference between the market price and the natural price, the greater the risk of a catastrophic collapse in demand and recession, if we are referring to a national economy, as well as of continuously increasing inflation, which disrupts the smooth functioning of the market and prevents economic growth. Therefore, in the long run, even the survival of the market or the economy is put at risk. We will examine the role of profit in economic cycles, as well as in our ethical principles, in greater detail in Chapter 5.

Another possibility is the case in which:

Market Price < Natural Price

This does not occur frequently, since such a price does not provide sufficient revenue to the factors of production and therefore cannot be sustainable over time. In addition, such a low price may be regarded as unfair competition and considered illegal. At the macroeconomic level, it could lead to

a deflationary crisis, which increases external debt in real terms while simultaneously reducing tax revenues in nominal terms, resulting in the collapse of disposable income and market demand. The latter phenomenon may also occur as a result of a decline in business profits, which creates an incentive for firms to leave the market. A phenomenon of stagnation emerges and unemployment increases.

Therefore, in order to maintain equality between the market price and the natural price consistently and over the long term—in other words, in order to achieve sustainability—a necessary condition is, firstly, absolute freedom of the market and the functioning of competition to a satisfactory degree.[156]

Depending on the degree of competition and on how strong or weak it is, we have the following forms of market:

1) Perfect or Full Competition
Competition is considered perfect or full when the following characteristics are present in a market:

a) A large number of firms in the market.

b) A homogeneous product.

c) Free entry and exit of firms from the market.

Perfect competition is the ideal form of market assumed by economic theory, since it produces equilibrium at market prices that approach the natural price of commodities. This equilibrium price maximizes the interests of both consumers, who purchase at the lowest possible price, and producers, who maximize their revenues, since a lower price increases the quantity demanded according to the law of demand. These characteristics of perfect competition contribute to this outcome, and I explain them in greater detail below.

a) Many firms produce and supply the good
This means that no individual firm has the ability to manipulate prices, since it cannot control market supply except to the extent that it itself contributes to it. This limits the possibilities for manipulation as the number of firms increases and, consequently, as the contribution of any particular firm to the total quantity produced becomes smaller.

Within a free market, in order for a transaction to take place, both sides must benefit from it; otherwise, they will not voluntarily enter into it. Therefore, firms attempt to be as competitive as possible by offering the best possible quality at the lowest possible price, which satisfies the interests of consumers. Since there are many firms in the market, consumers have the option of avoiding a firm that does not offer them the quality-to-price combination they desire. This forces firms to offer the lowest possible price, which cannot fall below the natural price, since a higher price charged by a particular firm would cause it to lose customers to cheaper alternatives and therefore experience a decline in revenue.

Workers also benefit, as they see their earnings increase because they have many options in the labour market. Competing firms offer the best possible conditions in order to attract the labour factor they need for their productive and general administrative operations. In a similar way, all social groups operating within the firm's environment benefit.

Indeed, during periods of strong economic growth, when many firms see their profits increase and expand their activities, they face the problem of finding labour and are forced to offer wages that could be said to exceed the natural rates. This increases the relative share of labour compared with the entrepreneur's profit or the return to the owner of capital, who are consequently forced to accept a reduction in their respective claims and in the value of their own labour, or a lower reward-to-risk ratio for the capital they have invested.

At this point, based on what we have discussed, it would be worthwhile to dispel a myth: that the free market or the ideology of liberalism is pro-business. The opposite follows from the above. Businesses do not want competition because it reduces their profit margins and pressures them to adopt a business ethic that, otherwise, if they had greater room for manoeuvre, they might not adopt. We can observe this not only in theory but also in reality.

Conditions of imperfect competition are often sought when firms pressure politicians to impose tariffs or taxes that restrict free competition, or to prevent the entry of competitors by maintaining closed professions, an issue related to freedom of entry that we will examine below.

Indeed, Adam Smith himself makes a characteristic statement about the class of businessmen: “they are not the sort of people I would wish my children to associate with,” while elsewhere he compares them even to criminals who simply possess sufficient capital, arguing that every proposal originating from this particular class of people should be treated with suspicion because it is a class with an interest in deceiving society.

Furthermore, we should not forget that Adam Smith's purpose was to oppose the system of commercialism, that is, mercantilism, and to unite people through free trade, which, if conducted cooperatively and in good faith, can generate greater benefits for everyone, including even the side of the “winners” of international trade based on protectionism.

b) Homogeneity of the product
The products of all firms are identical. This means that quality is given, while marketing techniques such as advertising become practically useless. Therefore, in order to become more competitive, a firm has an incentive to reduce its costs and increase the quantity supplied as much as possible.

This solution is effectively the only option available to a firm in a perfectly competitive market, which is why perfect competition is considered the ideal market structure in economic theory, insofar as it leads spontaneously to an optimal allocation of resources and limits their waste, thereby contributing decisively to addressing the fundamental economic problem. This assumption also means that advertising expenditure can be regarded as an unnecessary expense.

c) Free entry and exit of firms from the market
There are no barriers to entry or exit for firms in the industry. This benefits consumers, who thereby have more available choices, and ensures the fair price discussed earlier, namely the natural price of goods and commodities. The mechanism through which this occurs is as follows:

If there are only a few firms in an industry, meaning that we have an oligopolistic market, which we examine below, then the relatively small market supply ensures a higher price and a larger profit margin. It is also practically easier for a small number of firms to cooperate in order to manipulate the price and quantity supplied in the market than it would be if there were a large number of firms.

This is represented diagrammatically by a supply curve positioned at a relatively high level, above and to the right in relation to the demand curve. This high price increases the profit margin and creates an expectation of profit for those who recognize the opportunity and are willing to undertake the risk of combining the factors of production in order to carry out the production process—which also constitutes the definition of entrepreneurship as a distinct factor of production.

Rational producers, guided by the incentive to maximize profit, begin to enter the market and claim a share of the market and of the profits. This, in turn, increases total market supply and results in a shift of the supply curve downward and to the right relative to the demand curve.

In practical terms, this means that the economy becomes more competitive as product prices decline and quality improves, since consumers now have alternative choices when making purchases and can also have greater expectations. Employment, as well as the real wealth represented by goods, also increases as a result of this shift in the supply curve, leading to a reduction in the unemployment rate and an increase in wages without causing inflation, provided that there is also a real increase in the wealth produced.

Note that this benefit to the labour factor comes at the expense of entrepreneurship and capital, which see their share decline as the number of firms in the market increases. For this reason, they actually have every reason not to desire the freedom of entry of competitors into the industry. This is why it is very important for firms to have freedom of entry into an industry. This is what governments attempt to achieve when they speak of “opening up professions”, so that closed professions do not exist.

Our objective, however, is not only the interest of the consumer or the worker, but also that of the entrepreneurial and/or capitalist class—or, if you prefer, the balancing of these competing class interests. [157] If the price falls to such an extent [158] or if wages increase[159] and the firm begins to incur losses, this will encourage many firms to leave the market in order to limit their losses. As a result, supply will decrease and the supply curve will shift upward and to the left. The market price will once again become equal to the natural price, and equilibrium—equality—will be restored.

This argument can serve as an argument in favour of free trade and against protectionist policies, such as tariffs and quotas, and constitutes the condition and mechanism through which an automatic adjustment mechanism under a gold standard could operate successfully.

2) Oligopoly

This is the form of market in which a specific and relatively small number of firms compete for a share of the market. Since the first characteristic—that of a large number of firms—is absent, we understand that this is a market in which it is easier to manipulate both the price and even the quality of goods, since firms do not face strong competition and are in a position to cooperate and collude more easily at the expense of consumers.

In this case, by reducing the quantity of labour and therefore reducing their costs, firms can produce smaller quantities of goods that nevertheless generate greater revenues because of their higher prices. Consumers have no effective way of avoiding these prices because their alternatives are limited. The more limited these alternatives are, the more firms can increase prices in a free market.

The strongest indication of an oligopolistic market, in my view, is not so much the number of firms as whether barriers to entry are created for competitors in the industry. Otherwise, the marginal profit generated by a high price could attract competitors who would drive the price down.

Obviously, within an oligopolistic market we have:

Market Price > Natural Price

The supply curve does not tend to expand downward and to the right, because this would reduce the profit margin, especially in the case of an inelastic demand curve, which is particularly likely when there are not enough substitute goods in a limited market.

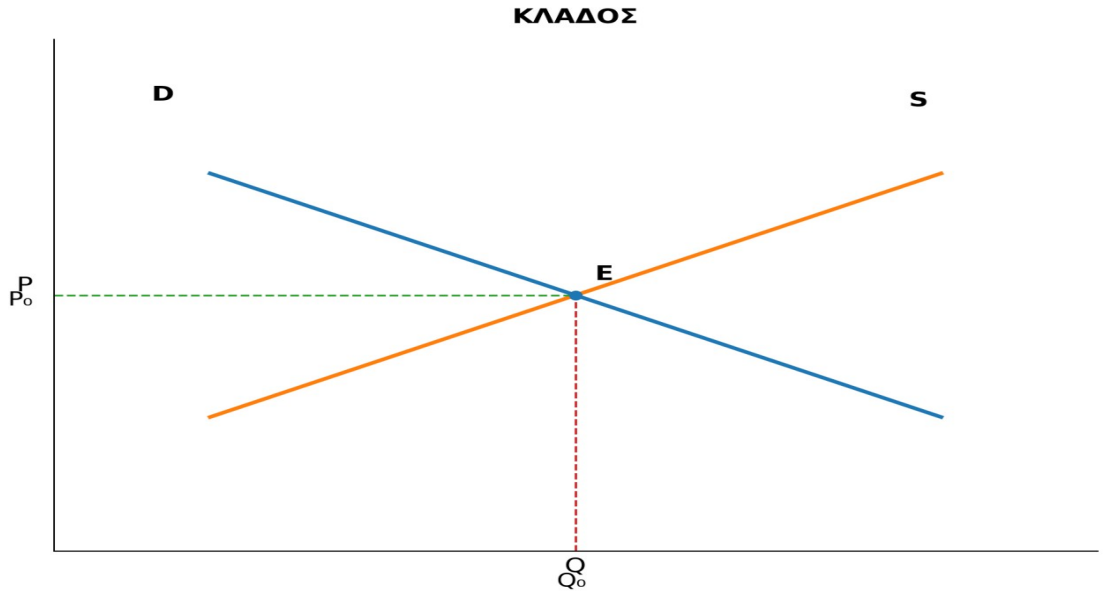
In this case, it is not in the sellers' interest to reduce prices because the benefit from the increase in quantity demanded does not compensate for the loss resulting from the fall in price in terms of total revenue. Therefore, in this case we cannot rely on the free market because there is no spontaneous tendency for the market price to approach the natural price.

The invisible hand of the market cannot ensure equilibrium between competing interests and must therefore be replaced by the “visible hand” of government. Either the market must be opened and barriers to the entry of new firms into the industry must be removed, even through investment subsidies if necessary, or prices must be compulsorily reduced through legislation and market-monitoring measures.

In the latter case, the firm or the market as a whole has an incentive to increase supply in order to reduce the shortage and thereby sell the unsold quantity. In other words, it can maintain its total revenue by compensating for the lower price with an increase in the quantity supplied through a shift of the entire supply curve, depending also on how elastic or inelastic the demand in the particular market is.

If demand is inelastic, the initial revenues previously maintained by the cartel cannot be achieved through an expansion of supply. Nevertheless, the firm improves its position by achieving equilibrium and eliminating the shortage.

These options require government intervention in the market, or the removal of restrictions when the barriers are caused by government actions and policies. The objective of the government is to reduce prices to their natural level.



Examples of oligopolistic markets include the cement and mobile telecommunications markets, where the product is relatively homogeneous; the market for electrical appliances (refrigerators, washing machines, ovens, etc.), with certain degrees of product differentiation; and the market for private automobiles, with significant product differentiation. Other examples include the markets for computers, newspapers and magazines, cigarettes, detergents, milk, etc.[161]

3) Monopoly
A market is considered a monopoly when there is only one particular firm producing the good and there are no substitute goods to which consumers can turn. In such a case, consumers are in a disadvantaged position and are forced to accept any increase in price.

A monopoly can arise for the following reasons:

a) The necessary raw material belongs to a particular individual or firm, e.g. oil fields.

b) Exclusive possession of know-how by a firm, e.g. multinational pharmaceutical companies that possess specific patents and can sell the rights to use them at high prices.

c) The state itself assumes exclusive production and supply of a good by law. This is known as an artificial monopoly; that is, it does not arise randomly or spontaneously but through government policies, whereby the state determines that, for various reasons, only one firm can better serve certain consumer or social needs.

d) Unfair competition gives certain firms a distinct competitive advantage through which they can eliminate their competitors and become the dominant or sole firms in the market. An example would be special exemptions from insurance or tax obligations that the state may provide to a particular firm, or the ability of certain large multinational corporations to sell their products below cost—that is, below the natural level—either by incurring losses in the local market and increasing the price in another market, or by sustaining general losses that a large multinational corporation is capable of bearing, unlike its smaller competitors, thereby forcing them out of the market.

A firm may also establish a dominant position through legitimate means and turn itself into a monopoly. This effort is connected with the next form of market structure.

Examples of monopolies in Greece may include state monopolies, such as the Hellenic Railways Organisation (OSE) and the Public Power Corporation (PPC).[19]

4) Monopolistic Competition

This market structure is called monopolistic competition because it contains characteristics common to both monopoly and perfect competition. Specifically, its common characteristic with monopoly is product differentiation, while its common characteristic with perfect competition is the existence of many firms.

Therefore, under monopolistic competition, secret agreements to manipulate prices cannot easily arise, and consumers have available choices because each firm's product is differentiated. This creates competition among firms for dominance and success in the market. Since products differ in quality, the price at which they can be sold to a rational consumer will also differ.

Examples of such markets include clothing stores, petrol stations, barbers and hair salons, private tutoring centres, hotels, restaurants, etc.

To conclude this chapter on market structures, I would like us to retain the idea that a free market is truly in a position of equilibrium not when the market price ensures equality between quantity supplied and quantity demanded, but when the market price equals the natural price, that is, the price that ensures equilibrium among the respective rates of remuneration for labour, profit (for entrepreneurial initiative), and rent (for the use of capital). The natural price also expresses the real value of a commodity, or what it actually costs its producers.[162] It does not mean equality between interests, but rather a fair distribution of profits according to a specific criterion: the labour required for their production.

Therefore, a truly balanced free market exists not when:

Market Price = Equilibrium Price
(i.e. the price at which quantity supplied = quantity demanded)

but when:

Equilibrium Price = Natural Price
*(the real value or cost measured in units of labour)[163]

2.5 The Moral Limits of Homo Economicus

The economic man (homo economicus) is the model we use in economics, as well as in other disciplines, to simplify the complex nature of human beings and draw conclusions that are useful for the subject matter of political economy, namely the questions arising from the fundamental economic problem, to which we will return in Chapter 6.

In order to simplify complex reality, we make an assumption. This assumption is a generalization concerning human nature. Specifically, we assume that individuals are selfish, pursue their own self-interest, and do not care about the interests of society or other people. Furthermore, they are self-interested, utilitarian, and seek to maximize their benefit or utility, whether as consumers or producers, workers or employers, or generally in whatever social position they may find themselves.

The theoretical model of behaviour originates from the philosophy of utilitarianism, which we discussed in the first chapter, combined with methodological individualism, that is, a focus on the individual rather than society.

The term homo economicus was first used by the utilitarian philosopher and economist John Stuart Mill in his essay On the Definition of Political Economy; and on the Method of Investigation Proper to It, written in 1836. According to this definition, “man is a being who desires to possess wealth and who is capable of judging the comparative efficacy of means to that end.” In other words, he desires to possess wealth and, for this purpose, is capable of comparing the relative effectiveness of the means available to him for achieving this objective.

This model constitutes the dominant methodology in economics, although its presence can also be observed in other disciplines, such as sociology and political science.[164] The maximization of profit and economic wealth is the fundamental objective of human beings, while every other social, moral, or psychological motive is set aside and ignored by the rational homo economicus, since it could stand in the way of this pursuit.

At this point, I would like to mention something that I consider particularly important. The model of the economic man is a working assumption, not a desirable model of behaviour. This can also be seen in the ethical philosophy of many liberal theorists, as well as in Adam Smith himself, who did not reject emotion. As a professor of moral philosophy at the University of Glasgow, Smith described, through his second major work, The Theory of Moral Sentiments, a model of morality that is closer to what is desirable. This model, however, also partly derives from human nature and is not an external authority imposed upon us.

In the next chapter, we will say more about the question of the compatibility of Adam Smith's two major works, as he was one of the great figures of the Scottish Enlightenment.

Another major figure of the Scottish Enlightenment was David Hume, who also produced extensive philosophical and social work, as well as economic writings on issues such as the balance of trade, the quantity theory of money, and political economy. However, I will not discuss his work as a whole here, but only one particular concept that he describes in his work A Treatise of Human Nature (1739–1740).

In this work, he identifies a problem that exists in philosophy and other social sciences and describes it through the concept of is–ought, meaning the distinction between what is and what ought to be. According to Hume, many theoretical scientists, philosophers, sociologists, economists, political scientists, etc., describe what human nature is like and then derive models of behaviour from it, without sufficiently explaining how this transition occurs. There is a gap between what is and what ought to be, and somehow this gap must be bridged.

In attempting to bridge this gap, errors may arise, such as the case in which a fact of the real world is elevated into a rule or guideline for correct behaviour, or the case in which a desirable model of behaviour is rejected simply because it does not arise spontaneously from our nature, from what we are, and does not currently occur in the real world. In other words, it is not yet a fact.

An interesting attempt to bridge this gap is the so-called theory of public choice or rational choice theory, which also operates within the tradition of classical liberalism. Rational choice theory and its proponents do not tell us that it is good for a person to be selfish or self-interested. Rather, they argue that if a theory does not take such behaviour into account, it cannot realistically operate in the real world.

The model of the economic man is the starting point; it concerns what is, and it would be a mistake to regard it as a model of desirable behaviour, because this leads to the formation of an ideology, such as neoliberalism or any form of laissez-faire capitalism.

This does not mean that the free market or classical liberalism should be rejected. However, by placing moral limits on the economic man, we arrive at a more balanced ideology, which theoretically resembles social liberalism, or a natural state of freedom that would be more a state of peace and harmony, as envisioned by the French philosopher Jean-Jacques Rousseau, rather than a state of war, as described by Thomas Hobbes or Immanuel Kant.

Although Kant does not see order and harmony in an anarchic state of complete freedom,[165] I would nevertheless like to borrow some of his ideas, such as his view that he does not reject the pursuit of happiness, but argues that this pursuit should take place within the limits of morality.

A similar view can be found in another liberal thinker, John Stuart Mill, who argues that individuals should be free to pursue happiness in whatever way they prefer, provided that they do not prevent other people from doing the same.

Moral limits do not arise as a result of coercion or restriction imposed upon the individual, but through the cultivation of the proper conscience, which leads to self-control and individual responsibility. This is also the direction taken by this book.

From the two perspectives we examined earlier, we can conclude that determining the boundaries between the “I” and the “we”, or between private and public interest, between concern for ourselves and concern for others or society, is not an easy question to answer. These boundaries must always be examined carefully.

In Chapter 5, through an example from game theory, we will see how concern for others may ultimately be a strategy that yields greater returns even for ourselves, compared with a purely selfish choice that a rational player might make.

The difficulty of finding the appropriate boundary is also evident in the two apparently contradictory works of the “father of political economy,” Adam Smith. These two phenomena will be explained in greater detail below.

---

115. Maslow's Pyramid is a theory of psychology that ranks human needs into five levels: Physiological Needs (food, water, shelter), Safety Needs, Social Needs (love, belonging), Esteem Needs (self-respect, respect from others), and, at the top, Self-Actualization (full realization of one's potential), explaining that basic needs must be satisfied before higher-level needs emerge.

116. Theodoros Lianos, Antonios Papavasileiou, Andreas Chatzianandreou, *Principles of Economic Theory, Third Grade of General Lyceum: Elective Course*, Diophantos Publications, 2000.

117. One characteristic that I would like us to keep in mind regarding the factors of production is that they constitute the basic criterion by which we can place an individual within a particular social or economic class. Social classes are groups of economic interests whose members are connected by common interests because of their relationship to the means of production. For example, those who belong to the labor factor constitute the working class, while those associated with capital or entrepreneurship constitute the bourgeois class.

118. In Section 2.3 we will say more about the methodology of rational choice and the tools provided to us by the basic economic principle.

119. Maria Ioannou-Serghiou, Neophytos Savvas et al., *Economics, First Grade of Lyceum*, Diophantos Publications, 2020.

120. Sofia Takaoglou, *Principles of Economic Theory, Third Grade of Unified Lyceum*, METAICHMIO Publications, 2003.

121. Maria Ioannou-Serghiou, Neophytos Savvas et al., *Economics, First Grade of Lyceum*, Diophantos Publications, 2020.

122. Panagiotis Rekleitis and Athanasios Filis, *Tax Accounting*, Diophantos Publications, 1999.

123. Justice in distribution is an issue that we will also examine in the following chapters and has two opposing sides. For this reason, identifying an optimal distribution is problematic, since those who contribute more to production should also be rewarded unequally with higher incomes, so that they have an incentive to continue producing.

On the other hand, wealth should be redistributed from richer to poorer countries because what causes food shortages, at least, is not the lack of a quantity of food sufficient to meet the survival needs of the world's population as a whole, but rather its unequal distribution, which deprives certain regions of food.

124. To support points 4 and 5, I will quote Jacques Diouf: “Hunger is not a matter of charity but of justice.”

Jacques Diouf was a Senegalese agronomist and politician, best known as Director-General of the Food and Agriculture Organization (FAO) of the United Nations (UN) from 1994 to 2011. He fought against hunger and for food security worldwide, emphasizing the dangers of food shortages and calling upon the international community to take action.

125. Maria Ioannou-Serghiou, Neophytos Savvas et al., *Economics, First Grade of Lyceum*, Diophantos Publications, 2020.

126. We encounter a similar view in James Buchanan. James M. Buchanan Jr. (1919–2013) was a distinguished American economist and educator, awarded the Nobel Prize in Economic Sciences in 1986. He is recognized as one of the founders of Public Choice Theory.

127. We saw earlier that overpopulation aggravates the basic economic problem. This law could help us understand why, while the population increases, productivity decreases.

Productivity is the key to understanding economic problems, and it would not be an exaggeration to say that all economic problems are caused by low productivity. Productivity, which can also be understood as average product, is equal to the value of the quantity of the good produced divided by the quantity/value of the productive resources used in the production process.

For example, **Q/L (Quantity/Labour)** shows the product per worker.

128. Theodoros Lianos, Antonios Papavasileiou, Andreas Chatzianandreou, *Principles of Economic Theory, Third Grade of General Lyceum: Elective Course*, Diophantos Publications, 2000.

129. We will return to this in Section 2.4 when we examine the forms of market.

130. From this fact we also derive the Law of Demand: when the price of a good increases, its quantity demanded decreases, provided that no other determinant of demand changes at the same time.

Likewise, the **Law of Supply**: when the price increases, the quantity supplied increases, because producers now obtain a greater profit and therefore have an incentive to offer larger quantities of goods.

These laws of the market arise as a consequence of two limiting factors: **income and prices**, which constrain the insatiable desire for the greatest possible utility.

131. I use the term “equalized” because I want to show that equilibrium in a free market is not the same thing as equality in a centrally planned economy of a socialist/communist model.

132. Theodoros Lianos, Antonios Papavasileiou, Andreas Chatzianandreou, *Principles of Economic Theory, Third Grade of General Lyceum: Elective Course*, Diophantos Publications, 2000.

133. Theodoros Lianos, Antonios Papavasileiou, Andreas Chatzianandreou, *Principles of Economic Theory, Third Grade of General Lyceum: Elective Course*, Diophantos Publications, 2000.

134. Source: Positive vs. Normative Economics, *Finance Management*.

135. Let us recall the words of John Maynard Keynes, who said that ideas shape the world and that ideas originating from philosophers and economists are more powerful than is generally understood, because they have the power to govern the world.

136. Human history evolves through a process of dialectics. Dialectics is an idea developed by the German philosopher Friedrich Hegel, according to which historical development takes place through the conflict of opposing concepts, from which a final synthesis emerges that approaches equilibrium or the golden mean.

137. Maria Vaxevanidou and Panagiotis Rekleitis, *Principles of Organization and Business Administration, Third Grade EPAL*, Diophantos Publications, 2015.

138. An important methodological tool that helps individuals when making decisions, in order to make a rational choice, is opportunity cost or alternative cost. It shows us what we sacrifice in order to gain one unit of a particular good.

For example, if a worker can produce, in one hour, 10 kilograms of wine or 4 kilograms of bread, then the opportunity cost of bread is:

10/4 = 2.5

because that is how many kilograms of wine he sacrifices in order to produce one unit of bread.

The opportunity cost of wine is therefore the inverse:

OC of wine = 1 / OC of bread = 4/10 = 0.4.

139. Average variable cost is the variable cost of a business divided by the quantity of output. Variable cost is the part of the cost that changes as the business intensifies its production activity, while fixed cost is the part of the cost that does not depend on the scale of production or the degree to which a business operates.

140. In Chapter 10 we will see how important technological improvement is for increasing productivity and reducing production costs, thereby strengthening competitiveness.

141. CA = Current Assets / CL = Current Liabilities.

Current assets and current liabilities refer to the claims and obligations of a business whose duration is less than one year. Long-term loans, buildings, land, etc. are not included.

142. Adam Smith, *The Wealth of Nations*, 1776.

143. Immanuel Kant, *Idea for a Universal History with a Cosmopolitan Aim*, 1784.

144. What the German philosopher Arthur Schopenhauer calls “the will to life.”

145. This means that it possesses a stable purchasing power and does not lose value over time, provided that it remains in relatively stable supply, which means that demand for goods also remains stable.

146. The idea according to which every household—and, more generally, every economic unit, e.g. the state—should produce for itself whatever it needs and should not depend on trade or exchanges with others.

The mercantilists later viewed commercial exchanges as a game of winners and losers, in which there is no mutual benefit for both sides of the transaction.

147. The source file's footnote 147 is interrupted in the extracted text. The portion that is actually recoverable reads:

> “However, the invention of money did not have only positive aspects in relation to barter. It may have increased the level of wealth and provided solutions to humanity's economic problem; however, …”

The continuation is not present in the accessible extracted text of the PDF, so I do **not** want to invent the missing portion.

148. Theodoros Lianos, Antonios Papavasileiou, Andreas Chatzianandreou, *Principles of Economic Theory, Third Grade of General Lyceum: Elective Course*, Diophantos Publications, 2000.

149. We observe that, in the final analysis, statism is based on consequentialism and on the doctrine that “the end justifies the means,” in contrast with the free market, which gives priority to its ethical principles, even though it accepts the consequentialist nature of human beings and refuses to restrict it, often failing in comparison with the results that government intervention can achieve.

However, this conclusion is not absolute. It applies in certain areas but not in others. For example, it may apply to alleviating extreme poverty and creating a welfare state, but not necessarily to creating a competitive economy.

This conclusion, I believe, leads me to think that only the ideology of **liberalism** may be compatible with the **ethics of virtue**.

150. The ethics of virtue arises not so much from reason as from emotion, although reason also plays a role in it. We see the enhanced role of emotion in Adam Smith and David Hume.

Smith, in particular, in *The Theory of Moral Sentiments*, connects it with Aristotelian virtue ethics and the formation of a virtuous character possessing empathy and a proper conscience. A proper conscience arises spontaneously from emotion and not from the imposition of rules.

151. The German philosopher Immanuel Kant, in his essay *Idea for a Universal History with a Cosmopolitan Aim*, states that even a people of devils may be capable of achieving socially desirable ends through competition.

152. The ideology of laissez-faire capitalism shares common elements with the idea of social Darwinism. Such common elements include innate selfishness, the pursuit of self-interest, and our innate tendency to seek pleasure, etc.

Both economic liberalism and social Darwinism reject government intervention and assistance to vulnerable social groups. In the first case, the argument is that assistance rewards poverty and thereby reproduces it, giving individuals incentives to leave the market and depriving them of the opportunity for productive creation that contributes to the prosperity of society and themselves, while simultaneously causing the individual to lose independence and become completely dependent on the state.

Subsidizing uncompetitive economic units multiplies their presence while tending to eliminate successful ones, ultimately harming the interests of consumers and the state, since the state itself cannot obtain the corresponding revenues.

In the second case, the argument is that such assistance to the weak will ultimately create a weak society; therefore, the state should not intervene and interrupt the spontaneous operation of natural selection, which also exists in human society. The similarity between the two views is evident.

153. That is, market price > natural price, because if the opposite were the case it would be considered unfair competition and this option could not be sustainable for the entrepreneur who chose to follow it.

154. We should not make the mistake of considering the entrepreneur's lawful profit for the intellectual work contributed by management as surplus value, nor the income from capital—that is, the income of the owner of the means of production—for the risk undertaken in supplying the interested parties with land and real estate, without which the productive process would not be possible.

One solution for avoiding the individual cost of entrepreneurship and capital would be for the state to undertake these functions. However, history shows that the state is far less capable of performing these functions, and that only when property belongs to a private individual is there genuine interest in and protection of property.

On the other hand, when property belongs to a private individual, there may be indifference toward society and justice —indifference toward the public interest.

155. Adam Smith, *The Wealth of Nations*, 1776.

156. Social classes are groups of economic interests, and what connects their members is their relationship to the means of production: labor, land, capital and entrepreneurship.

For simplicity, we could merge entrepreneurship and capital under the category of the **bourgeois class**.

For more information, see Karl Marx, for example, in *The German Ideology* and *Capital*.

157. Obviously, this refers to the case where:

market price < natural price of the commodity.

158. An increase in labor wages under conditions of perfect competition occurs simultaneously with a fall in prices and essentially means that, in the distribution of profits, the working class occupies an improved position relative to the employer class, or, alternatively, that the percentage of the commodity's price accruing to labor increases.

For example, if for every €1 of revenue, 10% previously went to labor-wage payments, it may now correspond to 20% of the €1.

The price, however, remains stable at the natural level because this ensures maximum revenue under conditions of perfect competition.

For an individual business, complete freedom and strong competition constitute a burden.

159. Examples of oligopolistic markets include the cement and mobile-telephone markets, with a homogeneous product; the market for electrical appliances (refrigerators, washing machines, cookers, etc.), with some product differentiation; the market for private automobiles, with significant product differentiation; and also the markets for computers, newspapers and magazines, cigarettes, detergents, milk, etc.

160. Theodoros Lianos, Antonios Papavasileiou, Andreas Chatzianandreou, *Principles of Economic Theory, Third Grade of General Lyceum: Elective Course*, Diophantos Publications, 2000.

161. Producers are not only wage earners and workers, but also merchants and private entrepreneurs who, through their own intellectual and physical labor and by assuming risk for their financial and real capital, contribute to the productive process.

162. Adam Smith, *The Wealth of Nations*, 1776.

163. This is a consequence of the convergence of the two sciences after the Second World War, after 1950, when state intervention and assistance were considered necessary in order to restore the damage left by this devastating war in national economies, markets, etc.

164. It is not that anyone does not desire absolute freedom; rather, such freedom may be a utopia, at least at the historical stage currently reached by humankind.

Nevertheless, humanity ought to move toward it and toward its maturation. We should not forget that what truly makes us moral is our own feeling and conscience, and it is not practically possible to force all people to follow a rule when they do not genuinely believe in it themselves or lack some personal motivation that supports it.

CHAPTER 3 — ETHICAL MOTIVES IN ECONOMIC BEHAVIOR

3.1 Market Values Through the Lens of Religion

“Religion is the recognition of all our duties as divine commands.” — Immanuel Kant.

From these words of the German philosopher of the European Enlightenment, we can understand the moral value of religion. Without it, from an ethical perspective, we find ourselves in the state of nature, which Kant regarded as a state of war and savagery. Therefore, the relationship between economics and religion is of particular importance within the framework of this book, since our aim is to establish an ethical framework around the functioning of the economy in order to make it more efficient and fair. In this context, I would first like to examine the views of Karl Marx and Max Weber on the relationship between economics and religion and then study some of the ethical principles of certain religious groups that are related to economics and the market, and examine how certain economic activities may promote the common good or cultivate an ethical framework that, from certain perspectives, appears fair.

Regarding the relationship between religion and economics, Karl Marx believed that it is the economy that determines religion and its moral content.[165] Max Weber, by contrast, argued that the opposite is true: religion ultimately shapes the market or the economic system.[166] Thus, for Marx, religion is a “reflection” of the economy, whereas for Weber it is a driving force capable of changing the productive model itself or the functioning of the market.

My personal view is that these apparently opposing positions actually share “common ground” and are, in reality, complementary rather than mutually exclusive. Religion appears capable of bringing about changes within the framework of the market and of shaping a different business, consumer, or managerial ethic, but not of completely overturning the productive model or creating an entirely new economic base.

For example, the capitalist system and the ideology of laissez-faire, that is, the free market, are certainly compatible with Christianity, which has individual freedom at its core and indirectly recognizes property as well.[167] Nevertheless, capitalism is not found only in the Christian West, but also in countries of East Asia, such as Japan. Indeed, the Japanese economy and its business and industrial activity could be said to surpass in capability and dynamism that of many Western countries in America and Europe, even though Japan was among the defeated countries in a devastating world war.

However, capitalism in the United States differs from capitalism in Japan, and even capitalism on the European continent differs from that of the United States. This is due to the different cultures and different ideas that prevailed in these countries. Among these ideas, which produce an ideology, we can include religion.

Japanese business ethics, which we will also examine in a later chapter, could be regarded as a product of the different religion of the Japanese people. In other words, the difference in religion in this particular case does not imply a different productive or economic model, but rather the

formation of a different business ethic. Japanese markets continue to contain large corporations and multinational companies with a presence in countries throughout the world and with great success. There are still financial markets, stock markets, foreign-exchange markets, and so forth. Tokyo is one of the major financial centers, and the yen is one of the most popular and well-known currencies in the foreign-exchange market.

It is therefore neither a different economic foundation nor different class interests, but rather a different strategy adopted by Japanese businesses in order to achieve better results. The example of the Japanese economy shows us that these two perspectives can coexist, since it was the economy that contributed to the formation of Japanese religion and not the other way around. For example, through an interest in tradition and consumers, or in quality rather than quantity, businesses seek to achieve higher profits and increase their wealth, which is an economic objective.

On the other hand, this different value-based approach also shapes markets. It may not completely change the productive model, but it does change the character of an economy and the position occupied by certain economic units within it. It can lead, spontaneously and without central planning, to a different distribution of goods, less inequality, and more ethical business practices, particularly with regard to the production process and environmental protection.

Therefore, Karl Marx's theory is correct, as is Max Weber's later theory, since religion shapes specific types of market ideology. For example, we could associate Protestantism with neoliberalism and Catholicism or Orthodoxy with social liberalism, both of which are forms of the capitalist system. In the Islamic world, religion appears to provide moral legitimacy to state intervention, but this does not constitute the formation of a new economy; rather, it serves different economic interests that find expression through this different religious ideology.

At this point, I would like to present three different religions and some of the important principles they advocate, and I would suggest that the reader recall the words of the great German philosopher at the beginning of this section. Specifically, I would like to examine Protestantism, and especially Calvinism, Judaism, and Japanese religion, since the Japanese economic model could also serve as a desirable example for the West to imitate.

Protestantism

Protestantism emerged from Catholic Christianity following the separation of certain protesting churches in the sixteenth century. More specifically, it began in 1517 with Martin Luther and the ninety-five theses that he posted on the door of the Castle Church in Wittenberg.

The emphasis on the values of reason, autonomy, and dignity did not permit tolerance of the practices of the Roman Catholic Church, which, through fear and submission and by keeping its subjects in a state of ignorance, exploited them through superstition in order to acquire greater power, authority, and economic strength. The Protestants opposed practices of the Pope, who sold indulgences and thereby transformed salvation into a commodity, and sought to restrict his power.

Historically, many branches and religious groups emerged within Protestantism. The most important included:

- Lutherans

- Calvinists / Reformed
- Anglicans
- Baptists
- Pentecostals

There are differences among these religious groups. However, I will focus on certain ethical principles of Calvinism that were considered particularly useful for the success of Western capitalism and that appear to have influenced the broader Western culture of Protestant countries.

[168] Such Protestant countries include the United States, England, Germany, Australia, Canada, and many other Western countries that are among the most economically successful. This economic success is certainly beneficial to their citizens, creates prosperity, improves their standard of living, and therefore one may, from this perspective, regard the emphasis on market values as an ethically desirable attitude.

First, there is the rejection by Protestantism of certain sacraments, such as confession and forgiveness. In Protestantism, only God can forgive sins, and this will occur only on the day of the Final Judgment. Therefore, the believer must follow the commands and desires of God.[169]

One of these desires of God is work. Protestant Christianity places particular value on work, and every type of work or profession is regarded as something sacred and as a duty of divine origin. This means that every professional, from the baker and cook to the teacher or farmer, performs a social function and carries out God’s will through his or her work.[170]

At this point, it is worth mentioning the doctrine of predestination. According to this doctrine, it has already been determined who will be among God’s chosen and who will not. Moreover, the chosen experience heaven already in this world through their economic wealth, which constitutes something resembling “divine grace.” Entrepreneurs and wealthy people belong to God’s chosen elite. This belief is an ethical principle that gave impetus to Western laissez-faire capitalism and helped shape the appropriate culture that led to the success of Western capitalist countries and to the enrichment of their inhabitants.

There is also an emphasis on community rather than the family. This belief encouraged cooperation and served as a substitute for the state, whose intervention was supposed to be limited to a minimum for the smooth functioning of the market and the improvement of economic performance. Furthermore, stealing from the community in order to benefit one’s family is regarded as reprehensible.

Another principle is faith in science rather than miracles. This belief meant that there were no miracles upon which one could rely and that only through personal development and investment in oneself could one improve one’s position. At the same time, the emphasis on science was a prerequisite for the development of technology and the necessary infrastructure that dramatically increased productivity and made Western Protestant economies more competitive.

This increased productivity and technology are what allow the workforce in these countries to be employed less in difficult jobs and more in pleasant or interesting occupations, while at the same time increasing the total amount of real wealth.[171]

Calvinists also place great importance on production, saving, investment, and the reinvestment of profits in the business when an entrepreneurial activity is involved, as well as on austerity, an ascetic lifestyle, and so forth.[172] Financial affairs, economic theory, and other economic sciences, such as business administration, became associated with Protestant ethics, as well as with Judaism, which we examine below.

All these ideas constitute a set of principles that shape an appropriate culture and ideology and create an environment compatible with the free market and capitalism.

Before examining the ethical principles of Judaism that are related to economics, I would like to refer more generally to Christian ethics and not only to its Protestant form.

One could argue that Christianity is a religion opposed to wealth:

> "It is easier for a camel to pass through the eye of a needle than for a rich man to enter the kingdom of heaven."

This biblical phrase is attributed to Jesus.[173]

Nevertheless, as we have shown earlier, Christianity indirectly recognizes property and places great importance on individual freedom. It promotes certain behavioral standards compatible with economic success, such as integrity, truthfulness, concern for others, generosity, and, above all, love.[174]

It is not accidental that after the Western countries belonging to the Protestant tradition, the other Christian countries follow in the rankings of economic prosperity. Spain, Italy, France, and Russia, for example, are Christian countries with developed economies and dynamic markets.

Obviously, if we also take into account the biblical phrase mentioned above, economies in Catholic and Orthodox countries tend to have a negative attitude toward the accumulation of wealth. This does not constitute a different economic system, but rather a different distribution within the same economic system.

Most religions condemn greed and inequality. Exceptions include Calvinism and Protestant movements that adopt its basic principles, but another possible and even more pronounced exception is Judaism.

Judaism

In Judaism, poverty and economic hardship are not regarded as virtues or as deserving particular honor or grace, as they are in some other religions. The pursuit of economic wealth is considered virtuous insofar as it is a precursor to prosperity both for the individual and families and for society as a whole.

The relationship between Judaism and wealth is a positive one, in contrast to Christianity, particularly Catholic and Orthodox Christianity, which views the pursuit of wealth as a sin. This ethical principle is rejected by Protestant Christianity.

For example, most religions, such as Christianity and Islam, prohibited charging interest on capital in lending. In Judaism, however, there was no such obligation, and this allowed the Israelites to develop lending and establish the first banks.

Two very important religious texts in Judaism are the Torah, which consists of the five books of Moses and constitutes the law, and the Talmud, which is also an exceptionally important religious work.

These works clearly express the position mentioned above. Another important work, consisting of a collection of texts by rabbinical scholars, is *Sages of the Talmud*, in Greek *Sophoi tou Talmud*, in which Mordechai Judovits presents interpretations and explanations of these texts. The work contains advice, instructions, and words of wisdom concerning the management of wealth and money, finance, investments, diversification, and risk management.

Indeed, the Torah contains a term that introduces a particular business ethic, which appears in one way to be expressed by the ideology of classical liberalism, the free market, and classical economic theory, which adopts perfect competition as the model form of the market.

Specifically, in the Torah we encounter the term *ona'ah*, a term of Jewish law meaning injustice or exploitation. It can have two meanings. First, it may refer to an injustice involving unfair pricing and therefore the attribution of a value different from the actual value of an asset or economic good. Second, it may refer to insult, psychological pressure, and humiliation of a person.

The common term used to express both situations shows that unfair pricing constitutes, in a certain sense, an insult and humiliation for the person who suffers it, whether that person is the owner of property, the seller of a commodity, or is otherwise involved in an assessment of value.

This unfair pricing or exploitation may take two forms: first, when someone charges considerably more than the fair value[175] in order to sell a good or asset; and second, when someone pays considerably less than the fair price in order to acquire the particular asset, taking advantage of the ignorance or need of the other party.[176]

Specifically, we read in the Torah, and particularly in Leviticus 25:14:

> "When you sell or buy… do not wrong one another."[177]

This means that any intervention or restriction in the market aimed at manipulating prices at the expense of consumers is considered oppression and deprivation of freedom.

This is also why businesses do not want competition and seek to restrict it: in order to manipulate prices more easily. A competitive market prevents them from doing so, as we saw earlier.

Japanese Religion

A series of similar ethical principles can also be found in the official Japanese religious tradition, although here they do not have the same strictness as law, but operate through a more flexible moral rule.

In Japan, the dominant religions are Shintoism and Japanese Buddhism, while a smaller proportion, approximately 1–2 percent, belongs to Christianity. Many people adopt elements partly from Shintoism and partly from Buddhism without clearly identifying with either religion and without seeing any contradiction in combining the two.

Shintoism promotes honest trade, without deception, as well as sincerity and good intentions. Traditionally, becoming wealthy at the expense of others and exploiting crises or need is considered wrong.

Japanese Buddhism, meanwhile, contains strong philosophical elements and condemns greed, the pursuit of excessive profit and accumulation of wealth, as well as causing harm or deception for the purpose of profit. On the other hand, it speaks of simplicity and moderation, promoting austerity, self-sufficiency, and respect for resources.[175–177]

The Japanese economy is one of the most successful economies in the world and possesses one of the strongest currencies, with export industries and multinational corporations that are widely known throughout the world and with a great diversity of production.

The Japanese miracle could be related to the business ethic that prevails in the country and to the well-known Japanese Management model, which gave considerable impetus to the country's economy.

If we consider that Japan belonged to the defeated side in a world war and nevertheless reached its present position, we can understand how successful the management model of Japanese businesses has been and how productive and competitive the national economy is.

More about business ethics in general, and Japanese business ethics in particular, will be examined in Chapter 5.

In shaping this business ethic and the principles governing Japanese companies with regard to social responsibility, corporate governance, and policy, the ethical principles of Shintoism and Japanese Buddhism concerning simplicity, avoidance of greed, a modest lifestyle, and so forth have certainly played a role, even if indirectly.

In this chapter, we examined certain ethical principles that are absolutely necessary within a free-market economy. Indirectly, we also saw that a free market, through strong competition, proper and complete information, and appropriate risk-sharing, aims to achieve the same ethical principles and not, as it often appears, to promote personal or business interests.

Within the market framework, self-interest is the means — not the end — that the liberal uses to guide individuals toward the achievement of the ultimate goal, which is equilibrium at the natural level.

The misunderstanding often arises because we have not studied precisely what Adam Smith himself says in *The Wealth of Nations*, and because many people ignore the first and greatest work of the Scottish professor of moral philosophy, *The Theory of Moral Sentiments*.

Yet even for those who know this particular work of the British economist, the apparent contradiction between the two works continues to raise questions and cause confusion.

3.2 The Problem of the Compatibility of Adam Smith's Two Works

This chapter addresses the problem at its core, because here we see how modern economics, by ignoring half of the work of its most important founder, can give a misleading picture of the purpose and responsibility of the economist's profession and of the ethics of the market and capitalism.

In the first chapter, we examined several schools of ethics and made particular reference to the ethical approach introduced by Adam Smith through the concept of "sympathy," the Stoic notion he discusses in *The Theory of Moral Sentiments* (TMS).

By emphasizing emotion and moral sentiments, Adam Smith does not reject the ethics of the European Enlightenment or the virtue ethics of antiquity. Rather, he tells us that the foundation of this morality is not reason but emotion.

He was not the only thinker to move in this direction. David Hume, Francis Hutcheson, and other theorists of the Scottish Enlightenment held a similar view.

The characteristic philosophers of the virtue-ethics school we examined were Aristotle and Plato. Both speak of the primacy of reason. However, this does not prevent Adam Smith, who clearly gives priority to emotion, from invoking Aristotle in *The Theory of Moral Sentiments*. Therefore, since the references coincide, we may indirectly infer the character of his ethical approach.

This conclusion is apparent from the fact that, in the chapter "Of the Sense of Duty," Adam Smith begins his discussion with a reference to Aristotle, who is the principal representative of virtue ethics, as we showed in the first chapter.[178]

Specifically, *The Theory of Moral Sentiments* contains the following parts:

Main Parts of the Work

1. **Part I: Of the Sense of Sympathy** — Explains how the ability to imagine what others feel, that is, empathy, constitutes the basis of moral judgment.
2. **Part II: Of the Sense of Propriety** — Analyzes the sense of what is appropriate and the sense of justice.
3. **Part III: Of the Sense of Duty** — Introduces the concept of the "Impartial Spectator" as a standard of moral judgment.
4. **Part IV: Of the Effect of Utility upon the Sentiment of Approbation** — Examines the influence of utility and social perceptions upon moral judgments.
5. **Part V: Of the Influence of Custom and Fashion upon the Sentiments of Moral Approbation and Disapprobation** — Examines how customs shape our moral perceptions.
6. **Part VI: Of the Character of Virtue** — Summarizes the virtues of prudence, justice, benevolence, and self-command, and examines their ideal balance.

The work was published by Adam Smith in 1759. From 1751 to 1764, he was Professor of Moral Philosophy at the University of Glasgow. He resigned in 1764 and travelled to France for two years. He returned in 1766 and began writing his second major work, which was completed in 1776: *The Wealth of Nations*.

During the intervening period of two years, the Scottish philosopher and economist Adam Smith visited France from 1764 to 1766 as tutor to the young Duke of Buccleuch, Henry Scott, 3rd Duke of Buccleuch, a member of the English aristocracy who was undertaking the Grand Tour of Europe.

During this period, the influence of the so-called Physiocrats[179] appears to have been decisive upon Adam Smith. From them emerged the French phrase “Laissez-faire,”[180] which became the slogan used by modern supporters of the free-market system. This influence from the Physiocratic school led Adam Smith toward the writing of his second major work.

In *The Wealth of Nations*, we find certain principles that appear to be opposed to those presented in *The Theory of Moral Sentiments*: self-interest instead of the common good of TMS, selfishness instead of the altruism of TMS, the pursuit of profit, emphasis on the individual rather than the whole, inequality rather than equality, and reason rather than the emotion emphasized in TMS.

To examine the two works in isolation is like looking at the sun without the moon, the day without the night, or drought without rain.

Neither of the two works is “good” or “bad” by itself. Together, they form the puzzle of an economy that operates within the limits of morality and allows individuals to attain flourishing.

A common denominator in both works is the emphasis on individual behavior, and neither focuses on state intervention or the welfare state.

How can the gap between these values be bridged? We demonstrated this earlier when discussing forms of the market and saw that competition in the market can produce a natural equilibrium that satisfies the interests of all to such an extent that we can speak of equality. At the same time, by addressing market imperfections, income inequality is reduced and the position of the ordinary worker improves.

To understand the differences between the principles presented in these two works, I believe we must also consider the historical context in which these ideas were formulated.

In eighteenth-century Europe, the ideas of the Enlightenment dominated, and these ideas led to certain violent revolutions, such as the French Revolution in Europe and the American Revolution in America for independence from England.

Alongside the European Enlightenment, however, there was also a differentiation within it, known as the Scottish Enlightenment. This movement placed greater emphasis on emotion and experience rather than exclusively on reason, was arguably less hostile toward the Church, and produced more ideas related to economics.[181]

The difference between the European and Scottish Enlightenments does not constitute a conflict but rather a different approach within the liberal space of the Enlightenment movement, although in some respects it resembles the Romantic movement that developed immediately afterward during

the eighteenth and nineteenth centuries and constituted a genuine opposition to the European Enlightenment.[182]

---

[179] The Physiocrats were a group of French economists of the eighteenth century, something like the first “organized school” of economic thought. The best-known Physiocrats were François Quesnay, the leader of the school and physician to Louis XV; Anne-Robert-Jacques Turgot, politician and economist; Pierre Samuel du Pont de Nemours; and Victor de Mirabeau.

[180] *Laissez-faire* is a French phrase that literally means “let it be” or “let it operate on its own.” In economics, it means that the state does not intervene, or intervenes minimally, in the economy; markets, prices, wages, and trade regulate themselves, and people act freely, following their own interests.

[181] Economic writings can also be found in Hume and Adam Smith, whereas among philosophers of the European Enlightenment, such as Immanuel Kant, Rousseau, or Adam Weishaupt, the emphasis was more strongly placed on philosophical and political questions.

This differentiation is also expressed in the apparent opposition between these two works. We could associate *The Wealth of Nations* with the European Enlightenment and *The Theory of Moral Sentiments* with the Scottish Enlightenment, which does not constitute an opposition but rather a differentiation within the same intellectual space.

The influence of the Physiocratic school upon *The Wealth of Nations* is also evident. The Physiocrats developed in France and represented an idea that clearly emerged from the European Enlightenment.

To conclude this section, I would personally say that I do not identify differences only between Adam Smith’s two works, but even within *The Wealth of Nations* itself when compared with the modern works of economists who invoke him, such as Friedrich Hayek or Milton Friedman.

For example, Adam Smith does not appear to have a particularly favorable opinion of the business class. His theory seems more concerned with protecting the interests of consumers and workers. Furthermore, he does not even use the word “capitalism” in his works.

He also evaluates value according to a different standard from his contemporaries. He adopts labor as a fundamental measure of value rather than utility, which emerged later through the influence of utilitarianism and *homo economicus*, a concept associated with John Stuart Mill.

However, these differences are the result of the historical circumstances we have discussed in this chapter. For example, the emphasis on emotion derives from the Scottish Enlightenment and the early ideas of Romanticism, while the labor theory of value is connected with Protestant ethics, which attributes particular value to work, equating it with the holiness of a monk or priest.[183]

This leads me more toward the conclusion that Adam Smith was not a philosopher or economist fundamentally different from his contemporaries, nor that he or his contemporaries cannot be regarded as representatives of laissez-faire and the free market.

It simply appeared that way because absolute competition did not exist at the time and the financial system was not as developed as it is in modern capitalism. The fundamental principles and ideas, however, remained the same.

If I may use an analogy, I would say that the free market of that period resembles a small lion, whereas the modern free market resembles a wild lion which, if left completely uncontrolled and free, can become a public danger.

The emphasis on emotion shapes virtuous character. However, when emotion guides economic behavior, confusion may arise and the final result may be an unconventional “marriage” that fails both to achieve a balance within a “society of selfish individuals” and to promote virtue.

This tendency is due to the *is-ought fallacy*, a concept discussed by David Hume and examined in the first part of the book.

3.3 The Concept of “Moral Preference” and Modern Models of Behavioral Economics

> “Sympathy/compassion is the basis of morality.” — Arthur Schopenhauer.

Emphasis on emotion directly creates virtuous individuals, and this is the morality toward which Adam Smith aims through his first major work.

Not all people, however, possess the emotional intelligence and virtuous character of the philosophers of the Enlightenment, whether European or Scottish, or of the Romantics who followed immediately afterward.

Most people are guided in an unconventional manner by their instincts and passions, and reason is inevitably a “slave of the passions.”[184] Therefore, the mere existence of reason is not sufficient to liberate human beings from their passions and from manipulation by their own nature.

The influence of emotion results in the emergence of two phenomena:

1. **Moral preference**
2. **Behavioral economics**

In Chapter 2, and specifically in Section 2.3, we saw that economics makes certain assumptions in order to simplify the complex nature of real human beings.

Some of these assumptions are, for example, that human beings are selfish and self-interested, that they pursue personal profit, and that they seek to maximize profit at the lowest possible cost or risk.

Furthermore, the individual is assumed to be guided by reason and capable of setting emotion aside when emotion negatively affects the achievement of his or her result or objective. This is why the individual is also described as “rational.”

This assumption, however, does not actually characterize 100 percent of human nature, nor does it characterize every individual. It would therefore be a generalization leading to complete uniformity to claim otherwise.

“Moral preference” refers to the tendency of human beings, in practice, to prefer certain behaviors over those predicted by the pure pursuit of monetary or personal profit.[185]

These behaviors arise from the values and personal moral rules of individuals, such as the principles concerning fair transactions and exchanges that we examined in the previous chapter.

These principles result in individuals voluntarily placing limits on their own personal goals and ambitions in order to do what they themselves consider right or fair.

These principles shape the culture and business ethics prevailing in a particular market or society, as well as the social responsibility of its organizations. We will examine these concepts in greater detail in Section 5.3.

The following are some examples intended to help the reader understand what is meant by “moral preference”:

1. An employer pays more than what the market “requires”[186] because he considers the opposite to be unfair.
2. A consumer does not buy products from a company that exploits workers or pays more for fair-trade or organic products.
3. A business does not sell products that pose risks to the safety and health of consumers or that originate from production processes that harm the natural environment: forests, lakes, seas, and also the animals living in the area.
4. A property owner rents his or her property at a lower price to certain categories of people because the owner considers their contribution to society or the economy important, or out of genuine concern and empathy, not wishing to exploit the difficult circumstances or position of another human being.
5. A consumer returns additional change that he or she received because of an employee’s mistake during a transaction.
6. A citizen returns money found accidentally in the street or elsewhere either to its lawful owner or to the police.
7. An investor avoids companies involved in tobacco, pollution, gambling, or weapons because he or she considers their activities socially harmful.
8. A bank avoids financing unethical business activities or reduces the mortgage debt of its depositors because it considers this ethically correct.

These are some examples of what we might call “moral preference.” More about business ethics and corporate social responsibility, which lead to similar behaviors and enrich this list, will be examined in Chapter 5 and Section 5.3.

Undoubtedly, these examples can be found in the real world. They are not products of imagination, and their existence demonstrates that the pursuit of profit maximization can be spontaneously limited by moral boundaries and a sound conscience developed through the cultivation of empathy and reason.

In the real world, benefit or utility does not include only monetary profit, but also non-monetary benefits, which businesses often use to motivate employees.[187]

We could speak of two types of rational behavior: **result rationality** and **value rationality**.[188]

The second phenomenon produced by emotion when it influences economic decisions is the creation of apparently “irrational” decisions, which sometimes may not have a negative economic impact.

The science that studies this phenomenon is **Behavioral Economics**.

Behavioral economics became indirectly associated with Adam Smith because of his first major work, *The Theory of Moral Sentiments*. Classical economics is also associated with Adam Smith and his second work, completed in 1776, *The Wealth of Nations*.

Therefore, behavioral economics is equally important to classical economics and should have the position it deserves both in universities and in secondary education. It has largely been ignored by the official economics taught through the educational system, where theories of efficient markets, perfect competition, and similar approaches examined in Chapter 2 continue to dominate.

Behavioral Economics derives its conclusions by combining psychology, economics, and neuroscience in order to describe behavior in the real world.

Characteristic behaviors include the following:

1. Loss Aversion

The pain of a loss is stronger than the pleasure of an equivalent gain.

Example: We do not sell a stock that has "fallen," hoping that it will rise again.

2. Present Bias

We assign excessive value to the "now."

Example: We prefer consumption today rather than saving.

3. Overconfidence

We believe that we know or can predict more than we actually know.

Example: Frequent trading with low returns.

4. Anchoring

We become attached to the first piece of information we hear.

Example: An "original price" makes a discount appear larger.

5. Mental Accounting

We divide money into "mental accounts."

Example: We spend a bonus more easily than our salary.

6. Herd Behavior

We do what other people do.

Example: Bubbles in real-estate or stock markets.

7. Regret Aversion

We avoid decisions that may make us regret our choice.

Example: We do not invest at all in order not to “be responsible” for a possible loss.

8. Confirmation Bias

We seek only information that confirms our existing beliefs.

Example: We ignore negative news about an investment.

9. Framing Effect

The same choice appears different depending on how it is presented.

Example: “90% success” versus “10% failure.”

10. Status Quo Bias

We prefer not to change anything.

Example: We remain on the same mobile-phone plan even though it is more expensive.

However, one should not assume that all these behaviors are always economically harmful, nor that every “rational” choice is always advantageous.

For example, if we recall from Chapter 2 the demand function, we see that it consists of an autonomous component and a component that depends on the prices of goods or the price level.

According to economics, a *homo economicus*, that is, a rational participant, will increase his level of consumption when his income increases or when he expects a future increase in income.

However, this behavior can lead to the phenomenon known as **lifestyle inflation**, which can become a trap for an individual who seeks to increase disposable income or wealth.

On the other hand, an “irrational” behavior by an “irrational” player may have a positive economic outcome. A characteristic example from game theory will be examined in Section 5.3.

The study of behavioral economics is absolutely necessary for understanding the real world and achieving success within it. However, it should not be examined separately from the laws of economics and the economic principle.

In classical economics, we assume adequate information and perfect knowledge, while human beings appear as completely rational beings.

In behavioral economics, by contrast, people are susceptible to cognitive errors because such errors are part of human nature and should not simply be discouraged. Often there is also unequal access to information, while people are guided by emotion rather than reason, which everywhere and always remains a “slave of the passions.”[189]

Its contribution to finance is particularly important, especially regarding the functioning of markets, which appear to be strongly influenced by the psychology of their participants.

Psychology appears to guide markets[190] more than reason.

From this we can draw several conclusions.

First, if this simplification of classical economics does not hold in the real world, then it is practically impossible to predict the evolution of market prices, at least on the basis of models that rely on an incorrect assumption.

It is more likely that one can predict markets by taking behavioral finance into account, and specifically **herd mentality**.

Markets move collectively, following particular trends, and the expectation of profit appears to prepare the ground for the next trend.

I do not wish to give the impression that real economic fundamentals are unimportant. On the contrary, markets simply fail to understand true value, and prices reflect this false value. The fact that it is a false value, however, does not mean that it fails to produce a real effect.[191]

This is particularly important from an ethical perspective because it is what causes a bubble or intensifies the natural cycles of a market or the economy, with the devastating periods of recession and stagnation that lead so many people to lose their income and suffer from depression.

In the long run, what is expected to happen is that fundamental data will prevail and the company will eventually be valued by the market at approximately what it is actually worth.[192]

However, it is possible for an initial rumor or fashion to push a company's trajectory either upward or downward and ultimately affect even its actual fundamental data, leading it toward definitive long-term failure or success.

---

[165] And not only religion, but every ideology adopted by individuals aims either to serve economic interests or to shape a particular model of the productive process.

[166] Weber, Max. *The Protestant Ethic and the Spirit of Capitalism*, 1904–1905.

[167] Let us recall that one of the Ten Commandments is "Thou shalt not steal," as well as the famous phrase attributed to Jesus: "Whoever has two tunics should give one to the person who has none; and whoever has food should do the same."

[168] Such Protestant countries include the United States, England, Germany, Australia, Canada, and many other Western countries that are among the most economically successful. This economic success certainly benefits their citizens, creates prosperity, improves their standard of living, and therefore one may, from this perspective, regard the emphasis on market values as an ethically desirable attitude.

[169] At this point, it should be noted that Protestantism places very great importance on the Bible, which constitutes something similar to a "law" for the believer.

[170] All these professionals are regarded as representatives of God and as something comparable, in terms of holiness, to the priests of the Church.

[171] In technologically developed countries, there is a tendency for the workforce to move from the primary sector to the secondary sector and from the secondary to the tertiary sector of production. Furthermore, if we compare technologically developed countries with countries that lag technologically, we see that the latter employ a much larger proportion of their workforce in the primary and secondary sectors and a smaller proportion in the tertiary sector, while the same tendency toward greater employment in the later stages of production is not observed.

[172] Weber, Max. *The Protestant Ethic and the Spirit of Capitalism*, 1904–1905.

[173] Matthew 19:24; Mark 10:25; Luke 18:25.

[174] The role of love for one's neighbor within the free-market system can be understood if we consider Adam Smith's first major work, written several years before *The Wealth of Nations*, *The Theory of Moral Sentiments*. In a free market, for the buying and selling of goods to take place, both parties must participate willingly and voluntarily, provided there is no third institution forcing them to transact. For this to happen, there must be mutual benefit from the transaction; otherwise, one of the two parties will abstain.

[175] We could identify this fair price with the natural price discussed by Adam Smith in *The Wealth of Nations*.

[176] This is why, in the perfectly competitive market, we assume complete knowledge and information, so that each side can protect its interests and prevent the other side from committing this type of injustice or exploitation.

[177] The Talmud establishes a limit of approximately one-sixth of the actual value. If this limit is exceeded, the transaction is considered invalid.

[178] The characteristic philosophers of the virtue-ethics school we examined were Aristotle and Plato. Both speak of the primacy of reason. However, this does not prevent Adam Smith, who clearly gives priority to emotion, from invoking Aristotle in *The Theory of Moral Sentiments*. Therefore, since the references coincide, we may indirectly infer the character of his ethical approach.

[179] The Physiocrats were a group of French economists of the eighteenth century, something like the first "organized school" of economic thought. The best-known Physiocrats were François Quesnay, the leader of the school and physician to Louis XV; Anne-Robert-Jacques Turgot, politician and economist; Pierre Samuel du Pont de Nemours; and Victor de Mirabeau.

[180] *Laissez-faire* is a French phrase and literally means "let it be" / "let it operate on its own." In economics, it means that the state does not intervene, or intervenes minimally, in the economy; markets, prices, wages, and trade regulate themselves, and people act freely, following their own interests.

[181] Economic writings can also be found in Hume and Adam Smith, while philosophers of the European Enlightenment, such as Immanuel Kant, Rousseau, or Adam Weishaupt, focused more strongly on philosophical and political issues.

[182] The Romantic movement developed immediately afterward, during the eighteenth and nineteenth centuries, and constituted a genuine opposition to the European Enlightenment.

[183] See Chapter 3.1.

[184] This phrase is used by David Hume in *A Treatise of Human Nature*.

[185] I use the term "monetary" rather than "personal" because empathy is also a self-interested emotion and contributes to a person's own benefit and happiness.

[186] Or "allows," if you prefer.

[187] Economists refer to the cost of guilt or the benefit of moral satisfaction. Thus, the behaviors described above can be explained on the basis of the economic principle and ultimately constitute a rational choice.

[188] These terms are found in Wendy Brown's *Undoing the Demos: Neoliberalism's Stealth Revolution*.

[189] This phrase is used by David Hume in *A Treatise of Human Nature*.

[190] I am referring to markets for movable and immovable assets, such as stocks in the stock market, real-estate transactions, or other investment products subject to market risk.

[191] Soros, G. *The Crisis of Global Capitalism: The Open Society Endangered*, 1988, PublicAffairs.

[192] At the price that Adam Smith would call the **Natural Price**, as opposed to the **Market Price**, which may deviate from it.

CHAPTER 4 — ETHICS AND MARKET FAILURES

4.1 Asymmetric Information, Moral Hazard, and Fair Prices

In this chapter, we will analyze several concepts that are interconnected and lead one to the next. We have already discussed the concepts of “natural price” and “market price.” The former is the minimum possible price that is nevertheless sufficient to ensure adequate compensation for all the factors of production that contribute to the production and supply of a good, while the latter is the price formed in the market, which may either deviate from or coincide with the natural price. We may also refer to this price as the “fair price.”[193]

In an investment or business initiative, all the factors of production that we examined in Chapter 2 contribute: (1) labor, (2) land, (3) capital, and (4) entrepreneurship, which is the ability to combine the above and may be regarded as a separate factor of production.

Each of these factors receives a reward for its contribution: labor is rewarded through wages, land through rent, and capital through profit or interest when it is the party that financed the investment. As for profit, part of it is reinvested in the business, while another part flows to the owners of the business in the form of dividends.

These three factors “fish” from the same “pool.” In other words, they all claim a share of the total revenue generated by the investment or business, and the way this revenue is distributed determines whether the compensation received by each party can be regarded as fair or not. By analogy, we could consider that each party claims a portion of the price of the goods being bought and sold.

In a fair world, profits should be distributed among these factors, not necessarily in equal nominal amounts, but in a fair manner that compensates for all the disadvantages and risks they undertake. For example, the entrepreneur should be rewarded for the risk assumed, particularly if borrowing was necessary to acquire the capital and there is always a possibility that sales will not be sufficient to recover the investment and obtain the money committed, together with an additional profit as an incentive for participating in the productive process.

If the entrepreneur rents the land rather than owning it, there should also be compensation for the owner of the land; this compensation is rent. Finally, there should naturally be compensation for the worker as well; this compensation is the wage.[193]

In reality, however, if we look at the matter practically rather than theoretically, each side is primarily concerned with its own share of sales or revenue, often at the expense of the other groups. Here the assumption of the rational *homo economicus* appears to be realistic to a certain extent. This is why the economic principle remains a relevant method that allows us to analyze and understand the social sciences.

We recall that, according to the basic economic principle, human beings—whether they are producers, consumers, workers, or occupy any other social role, including that of a public official—are guided in their decision-making by the forces of personal cost and personal benefit.

Therefore, if, for any of the parties participating in the economic process, the costs exceed the benefits, that party loses the incentive to participate in the market and withdraws from it. As a result, productive activity cannot ultimately take place and all workers may remain unemployed.

It is therefore extremely important, for the common good and the public interest, but ultimately also for the benefit of the individual, that there be a balance between these competing interests. To achieve this, a process of negotiation takes place through which each side attempts to satisfy its demands. However, the game is not played on equal terms, because not every party possesses the same bargaining power. It would not be useful to discuss all the causes of this bargaining inequality in detail in this chapter; for now, I will focus on only one of them.

We saw in Chapter 2 that another assumption made in economic theory is the existence of perfect knowledge, meaning that each party is able to access the information necessary for a fair negotiation that will lead to market prices capable of balancing these competing interests.

We could speak of **information symmetry**, meaning that each party has equal access to knowledge and information. If this does not occur, the game is not played fairly, and there is a risk that one of the two parties will attempt to exploit or deceive the other by taking advantage of the information gap, which naturally and predictably produces ignorance on the part of the other party to the transaction.

This risk is called **moral hazard** and is the result of an unequal distribution of information, a situation that we could also call **information asymmetry**.[194]

The following examples will help the reader understand what moral hazard and information asymmetry mean.

The “Lemons Problem”

The **lemons problem** is an economic theory that explains what happens when there is asymmetric information between a buyer and a seller.[195]

Let us assume that we have a market for used cars in which sellers know whether a car is good or a “lemon,” while buyers cannot distinguish between the two. Buyers therefore offer an average price because they are afraid of overpaying for a defective car, or “lemon.”

This price, however, is lower than the price corresponding to the actual value of a good car. This gives the owners of good cars an incentive to withdraw them from the market, just as an entrepreneur or worker withdraws from the market when the market price falls below the natural price that can ensure their survival.

By contrast, with regard to “lemons,” that is, defective cars, the average price is higher than their actual value, and this increases their supply in the market.

The combination of these two effects creates a market dominated by low-quality products while products of genuine value are withdrawn. Quality in the market therefore declines, and this can even lead to the collapse of the market.

This phenomenon can occur in all markets involving buying and selling and voluntary negotiation—for example, the stock market, the real-estate market, insurance markets, the labor market, and so forth.

It is worth mentioning that the lemons problem is not always caused by our tendency to consider an average price. It may also be a problem associated with the basic economic principle itself and with the objectives of a "successful" negotiation.

Even when both sides know the true value and quality of a good, as long as there is a conflict of interests—with the buyer seeking to purchase at the lowest possible price and the seller seeking to sell at the highest possible price—they have an incentive to negotiate for a better price, regardless of how they assess the value of the particular good.

Depending on the outcome of the negotiation, we can determine what will happen in the market. If, for example, a buyer succeeds in negotiating a lower price, this is positive for that buyer. However, if all buyers obtain the same lower price, which they knowingly understand to be an undervaluation of the good they wish to purchase, the same phenomenon described above may occur. What I want to show is that the cause of this phenomenon is not exclusively an incorrect assessment of value, but often the economic principle of maximization itself. This principle may motivate individuals to sacrifice quality in their attempt to achieve maximum profit. This means that such "rational" behavior, if left without constraints, may ultimately lead to losses for the individual and to the collapse of the market. In Section 4.3, we will see another example showing how a "rational" transaction can ultimately have a negative overall result for both parties to the transaction.

How, however, is this phenomenon connected with the concepts examined in this chapter?

First, there is **information asymmetry**, because sellers know the quality of the cars while buyers do not.

Second, there is **moral hazard after the transaction**, because good cars leave the market under the pressure of the risk of being undervalued.

We have already seen an example of moral hazard, but we have not yet provided a definition.

Moral hazard in economics is a situation in which an individual or organization takes greater risks because it will not bear the full cost if something goes wrong.

In other words:

> When someone is protected from the consequences, they have an incentive to behave more recklessly.

Examples include the following:

- Someone with full car insurance may drive less carefully because the insurance company will pay for the damage.
- If a bank believes that the state will rescue it in the event of a crisis ("too big to fail"), it may take excessive risks. Likewise, a borrower who knows that he or she will not lose property by ignoring debt obligations may contribute to systemic risk for the banking system as a whole through the creation of non-performing loans and losses.

- An employee may reduce his or her effort if they know that dismissal is difficult.

In the next section, we will examine the broader consequences that information asymmetry and the moral hazard arising from it may have.

4.2 Externalities and Social Cost

The concepts we examined in the previous section—information asymmetry and the moral hazard that may subsequently arise because of it, but also sometimes because of government intervention that restricts voluntary transactions—are both market imperfections.

If we recall the market structures discussed in Chapter 2, we will remember the model of perfect or complete competition, which constitutes the ideal market toward which classical liberal economics aims through both its positive and normative philosophy.

The same philosophy underlies the **efficient-market hypothesis**, according to which prices incorporate all available information concerning the product being traded. This concept is used primarily to understand stock markets and the securities traded in both primary and secondary markets.

When the market operates in the optimal manner predicted at the theoretical level, there is mutual benefit for each individual and for each party to the transaction.

The absence of adequate knowledge and information and the presence of moral hazard are two imperfections that threaten economic—and more generally, individual—freedom, because addressing them may require government intervention. Yet government intervention itself may sometimes create an additional moral hazard.

These, however, are not the only imperfections of a free market.

In this section, we will examine another type of market imperfection that deserves particular attention because it lies at the heart of ethics, and especially the ethics of economic liberalism.

This is what economists call **externalities**, which elsewhere may also be described as the problem of **side effects**.

In economics, **externalities** are the positive or negative effects of an economic activity on third parties who do not directly participate in the transaction. These effects are not reflected in the market price, and the affected parties are neither compensated nor required to pay for them.[196]

Therefore, if someone suffers harm and is not compensated, this constitutes a clear violation of that person’s rights. Since the person receives no compensation for the harm suffered, there is obviously no consent on their part to the economic activity in question.

If, on the other hand, someone benefits from an activity but, given the circumstances, is able to avoid paying the cost of that good or service, then we again have a violation of the rights of those who ultimately pay for the provision of the good in the market. They are forced to bear a larger share of the cost than would normally correspond to them.

This occurs because nothing in the market is produced without cost.[197]

This situation creates the **free-rider problem**, or the problem of the “free rider.” Addressing it requires government intervention so that those who avoid paying for the provision of a particular good are compelled, through taxation,[198] to bear the share of the burden corresponding to them. This is why such cases usually concern public goods.

However, even this solution is not always sufficient to resolve the problem, because individuals are often unwilling to pay their corresponding share and may devise ways—either legally or illegally[199]—to avoid this personal cost.

We will examine this phenomenon in Chapter 8, where we discuss taxation. In Chapter 6, I will propose an alternative economic policy which, in my personal view, is entirely compatible with economic science and with the ideology of classical liberalism.

Such an ideology ought to respect the personality and freedom of the individual—that is, the principle of individualism—and should avoid making generalizations by focusing on larger groups, such as the market, which is itself a generalization and a group.

A social class or a trade union, for example, constitutes a group. Nevertheless, the interests of its members may conflict and may not actually be common in every case. When this happens, the group may dissolve or become dysfunctional.

In the same way, the interests of members of a market may diverge from what is regarded within the market as its "equilibrium state," with similar consequences for its members.

Returning to the problem created by side effects, and in order to help the reader understand what we mean, it is important to provide several examples, together with possible solutions to these problems that would be fairer according to the ethics of freedom.

As we have shown, there are both **negative** and **positive externalities**.

Negative Externalities

Negative externalities occur when an activity imposes costs on third parties.

Examples include:

- Production in a factory causes pollution.
- Smokers in an enclosed space affect the health of others.
- Noise pollution from nightclubs.
- A classic example is air pollution caused by industries or automobiles.

These examples help the reader understand the concept, but I would like to focus somewhat more on a particular category of side effect or externality: the banking system.

In the previous section, we saw that large and systemically important banks cannot simply be allowed to collapse because this creates a social cost and burdens depositors and taxpayers as a whole.

Thus, large banks, knowing that the state will intervene to rescue them, may become complacent and undertake greater risks than they can actually tolerate, knowing that they will not bear the full consequences of their decisions.

This creates a clear side effect because the failure of one bank may trigger a domino effect of banking failures and impose costs on people who bear no responsibility and who did not approve the risky investment decisions that led to the banking failure.

Therefore, this risk is not merely a market risk affecting the interests of the bank's shareholders, nor is it exclusively a systemic risk threatening the collapse of the banking system as a whole. It is essentially a **public risk**, and as such it clearly justifies intervention by the state or by other public or supranational organizations, such as the IMF or the World Bank, even during periods of economic growth, since the state has responsibility toward its citizens.

Such intervention may involve legislative regulation or even direct control over the management or ownership of banking institutions. It is entirely compatible with the principles of classical liberalism.

To demonstrate this, I would like to recall the words of John Stuart Mill:

> "The only freedom which deserves the name is that of pursuing our own good in our own way, so long as we do not attempt to deprive others of theirs, or impede their efforts to obtain it."

Negative externalities and side effects clearly violate this ethical principle.

Positive Externalities

The second case concerns **positive externalities**, namely situations involving goods or economic activities that benefit more people than those who pay for the provision of the good in the market.

Those who do not pay the share corresponding to them are called **free riders**.

Examples of positive side effects or externalities include:

- Vaccination reduces the spread of diseases and protects people who are not vaccinated.
- Education increases the educational level of society.
- Maintaining a beautiful garden increases the value of surrounding houses.
- The provision of highways, at least in the case of roads available for general access.[200]
- The provision of urban buses that allow everyone to travel, including those who travel without paying when effective control is not feasible.
- The national army, which is responsible for security, since protecting the few practically requires protecting the population as a whole.
- The existence of a justice system for the orderly functioning of society.

I would additionally dare to add the protection of animals to the above list, either through the creation of an animal-protection police force or through public expenditure for feeding and vaccinating stray animals with the assistance of municipalities.

Externalities or side effects are somewhat similar to the side effects of a medicine for a patient. Obviously, limits or specific regulations should exist in order to prevent activities that violate these rights and freedoms.

4.3 The Relationship Between Economic Success and Ethical Values

We have examined several cases that make government intervention necessary, even with regard to the protection of individual rights. In this section, however, we will examine which ethical values contribute to economic success.

First, one must define what success means to oneself, because success is, to some extent, a subjective concept.

A person may consider themselves successful because they managed to influence the lives of other people, satisfy the needs of others, or provide a socially beneficial service, even though such activity may not generate the income that could be obtained from an “antisocial”—if I may use the term—economic activity.

Others may consider success to be the reputation generated by an activity, while others may define it in terms of the property and money they have accumulated.

For others, the product itself may be the reason they feel important or proud of their work and therefore successful.

For many wealthy people, another very important criterion of success is the saving of time, which is the most valuable asset we possess in life and one that cannot be replenished.

The time, security, and freedom provided by economic success are undoubtedly criteria of success. This is why many investors, entrepreneurs, producers, and economic actors in general, regardless of their role, measure economic success not through financial indicators such as ROI, but through ROT:

ROI = Return on Investment = Net Profit / Equity Capital

ROT = Return on Time = Net Profit / Unit of Time (hour, day, etc.)

The issue discussed here is also connected with the question of corporate social responsibility and business ethics, which we will examine in greater detail in the next chapter, particularly in Section 5.3.

Often, when we give priority to socially desirable objectives or place the ethical principles of altruism and humanitarianism above economic self-interest, this may result in economic failure and ultimately limit even our ability to pursue socially desirable goals.

Consider the following examples:

- When we attempt to secure high-quality goods and, as a result, spend our money to the point where we no longer have sufficient liquidity, whether we are dealing with a household or a business.
- When a business wishes to organize certain events or provide a public good, thereby increasing its operating costs, which are subsequently passed on to the final consumer, potentially reducing total revenues and creating further consequences both for the business itself and for the interests of the state, which theoretically represents society.

- When a senior manager or supervisor is excessively lenient toward subordinates out of respect for their freedom, but as a result the employees are unable to organize themselves properly and become less productive because they lack the guidance they need from a supervisor.
- When someone cannot tolerate the cost of a conflict of interests and therefore avoids confrontation or avoids raising issues that may cause tension—for example, when an employee avoids discussing a possible salary increase with an employer, or when a family avoids discussing financial matters because they cause psychological strain for some of its members.
- A similar situation may occur when someone is unable to demand money or other forms of capital that other people owe them.

From these examples, we can conclude that when an individual ceases to think about personal interests and instead gives priority to the interests of others or society, they may risk economic failure.

On the other hand, an exclusive focus on oneself may also negatively affect success in the market, particularly when the actions involved are so socially condemned that they damage reputation and credibility.

Therefore, this issue requires delicate balances, and it is not easy to determine with certainty what the ideal boundary between “I” and “we” should be.

Often, what motivates us to create a business or a product, provide a service, and so forth is self-love, egoism, self-interest, and the desire to stand out and appear superior—that is, a tendency toward narcissism—as well as a desire for dominance.[201]

By contrast, a calm and peaceful personality that embraces ethical principles friendly toward society and other people may often lack the motivation required to participate and be productive.

For such a personality, a more important motivation might be to regard the object of their work as important and socially useful, while monetary compensation might even discourage rather than motivate them.

The first type of personality would find its motivation in a free market and the economic system of capitalism, while the second might find it in a centrally planned economy and in the economic and political system of socialism.

The appropriate mixture between the market and the state ultimately depends on the character of the individual and on which of the two systems is compatible with that human nature.

We will return to this issue in Chapter 7, where we will once again discuss the boundaries between the state and the market.

Although the first type of character appears to fit a free market, while the second appears to fit a socialist economy, what I wish to demonstrate through this book is the need to combine these two cases instead: to cultivate virtuous citizens within a free economy.

This is why such a large part of the first section of the book is devoted to ethical theory.

This is not particularly strange. Adam Smith himself appears to have desired something similar, judging from the apparent incompatibility between his two works, which we examined in the previous section.

Personally, I would say that in matters of an economic nature, individuals have limited room for sensitivity or altruism. Nevertheless, it would be morally preferable to sacrifice something of one's own rather than take something away from others.

Our attitude toward society and other people in political or civic matters is different from our behavior in the market.

For example, we can offer kindness and goodwill, and even demonstrate self-sacrifice, without incurring a monetary cost. But if we give away money, this may lead to our own financial destruction.[202]

Moreover, charity and benevolence, insofar as they subsidize poverty, may reproduce it and, from the perspective of society, ultimately make society poorer.

We should not fall into the trap of assuming that an isolated case of assistance from society—whether through the state or through other groups within civil society—to an individual in need is equivalent to a generalized culture of redistribution from the rich to the poor.

That would be an example of what economics calls the **fallacy of composition**.[203]

Ultimately, whatever leads to success in any system can also lead to success in capitalism, because human beings must adapt to the conditions of their environment in order to survive.

This view became associated with so-called **Social Darwinism**, which has been characterized in extremely negative terms, even as a form of vulgarity. However, if it reflects a fact of reality, it should not simply be dismissed. Instead, it should be examined from another perspective: as part of human nature and as a starting point from which we can move toward the point we wish to reach.

Capitalism and the free market share common ground with this ideology, and this common starting point is where both perspectives begin.

Social Darwinism refers to the tendency to regard Charles Darwin's scientific theories concerning natural selection and the survival of the fittest as applicable to human societies.

Influenced by Darwin's writings on the mechanisms and forces that drive evolution and continuity in nature, particularly among living organisms, Social Darwinist theorists believed that social life was structured and evolved in a similar manner.

The term **Social Darwinism** entered the European social and political scene in 1877 and emerged from ideas associated with Thomas Malthus, Herbert Spencer, and Francis Galton.

Although not all of these thinkers were later than Darwin, many of their views clearly pointed toward a social dimension and application of Darwinian theories of evolution.

In the United States, the theory became particularly influential.[204]

It is important to recognize the practical distinction between the biological observation that organisms adapt to their environment and the normative claim that society ought therefore to permit or encourage the elimination of those who are less successful.

Social Darwinism was later popularized in particular through the idea of the “survival of the fittest,” a phrase more closely associated with Herbert Spencer.[205]

According to Social Darwinism:

- Social groups and individuals “compete” with one another.
- The most “capable” or “strongest” survive and progress.
- The poor or weak are regarded as responsible for their own position.
- Government intervention, such as social welfare, is considered an interference with “natural selection.”

The similarities with some of the fundamental components of laissez-faire capitalism are apparent, since both theories appear to justify or accept selfishness, competitiveness, and the human desire for dominance.

Nevertheless, although Social Darwinism is historically a dangerous ideology that has caused harm to humanity, it should not be ignored when considering its starting point and its assumptions about human nature.

We must not fall victim to the **is–ought fallacy**.

If survival depends upon these characteristics, and if otherwise they would not have been given to us by nature, then it follows—within the descriptive framework of this argument—that a capitalist ethic, at least with regard to economic decisions, can lead to economic success.

Charles Darwin spoke of the survival of species in nature, while Herbert Spencer later used the phrase “survival of the fittest” and applied it to human societies.

This is not necessarily mistaken as a description of certain competitive tendencies, since human beings are themselves part of the natural world.[206]

From this emerged the idea:

Economic success = an indication of “superiority”

Poverty = an indication of “weakness”

If this idea is used as a foundation for a harsh form of neoliberal capitalism, or for an anarcho-liberal idea according to which part of society should simply be left to its fate because it constitutes a “threat” to society, then it is obviously problematic.

If, however, it describes a genuine tendency within human behavior, then it could potentially help us create healthy societies in which the survival of everyone becomes more likely.

This would be closer to the idea of **social liberalism**.[207]

The idea could be useful if we view it as a tendency of human existence and, as such, if we harmonize our institutions with that tendency.

It can then provide hope for creating a better society in which the survival of the less capable or less fortunate becomes more likely.

We should not regard it as a theory that morally legitimizes the elimination of particular population groups, but rather as a theory that offers incentives and a possible framework for creating healthy societies.

This means that government assistance cannot be unlimited and that some people must be left free to develop through their own efforts.

State welfare should be designed in such a way as to ensure the survival and basic security of those who are less capable or unfortunate, rather than those who are capable of competing on their own in this struggle for survival.

---

[193] Smith, Adam. *The Wealth of Nations*, 1776.

[194] This is also why certain mechanisms of information and disclosure were developed, such as the obligation of listed companies to publish their financial statements in order to protect investors. Another example is credit-rating agencies, which rate bonds and shares so that interested parties can understand the risks they undertake when deciding whether to buy or sell securities. The financial and property information submitted to banks by loan applicants is another example.

[195] The concept originates from George Akerlof's article "The Market for Lemons" (1970). In American slang, a "lemon" means a defective product, such as a faulty used car.

[196] Friedman, Milton. *Capitalism and Freedom*, translated by Giorgos Karampelas. Kyriakos Papadopoulos S.A. Publications, 2012, p. 61.

[197] "There is no such thing as a free lunch" is a common expression in economics.

[198] This taxation may take the form of a special consumption tax, VAT, or income tax, depending on the particular case.

[199] When this occurs legally, it is called **tax avoidance**, whereas when it occurs illegally, it is called **tax evasion**.

[200] Friedman, Milton. *Capitalism and Freedom*, translated by Giorgos Karampelas. Kyriakos Papadopoulos S.A. Publications, 2012, p. 62.

[201] For example, it would be economically more rational and prudent for an individual or legal entity to assess the risk undertaken—whether entrepreneurial or market-related—and mitigate it by sacrificing some potential profit. This is often easier for someone who thinks altruistically, taking into account the possible social consequences of a failed investment, than for someone who thinks exclusively in selfish terms.

[202] The instruction given during flights, according to standard safety procedures, is that in an emergency passengers should first put on their own oxygen mask before attempting to help anyone else. This is a characteristic example.

[203] The fallacy of composition in economics is a logical error that occurs when we assume that what is true for an individual or a small group must also be true for the economy as a whole. A classic example is saving. If an individual saves more money, their financial position improves. If everyone saves simultaneously, however, consumption falls,

sales decline, production decreases, and unemployment rises. This is known as the **paradox of thrift**, a concept analyzed by John Maynard Keynes.

Another example is wage reduction. For an individual business, reducing wages lowers costs. If wages fall throughout the economy, however, purchasing power decreases, demand falls, and business revenues decline.

The fallacy of composition shows that the economy is not simply the "sum of individual decisions." Collective effects can differ from individual effects, and macroeconomic analysis is therefore necessary in addition to microeconomic analysis.

[204] Source: Wikipedia, "Social Darwinism."

[205] According to Social Darwinists, such intervention distorts the natural processes of reproduction and evolution of species—including human beings—and therefore, instead of healthy societies, produces weak or unhealthy ones because the less capable ultimately prevail. This tendency was also regarded as a potential threat to humanity, since if the most adapted individuals do not prevail under the relevant environmental conditions, the species itself may be endangered.

[206] David Hume appears to share a similar view in *A Treatise of Human Nature*.

[207] Some characteristic representatives of this idea were John Maynard Keynes and John Rawls.

CHAPTER 5 — PROFIT AND ITS LIMITS

5.1 The Philosophical Debate on Profit

Social Darwinism, which we examined earlier, refers to the survival of those who adapt in the best possible way to their environment. The term originates from Charles Darwin, who observed this tendency in nature. The theorists of Social Darwinism, such as Spencer, considered that something similar occurs in human society, which constitutes a subset of nature.[207]

Depending on the way in which society and its political and economic system are structured, we can understand these criteria of survival. For example, in the economic system of the West—and of other Arab or Asian countries—namely, capitalism, there is the model of *Homo Economicus*, the rational human being whom we examined in Chapter 2.

The more closely an individual adapts to this model, the more likely they are to survive, whereas the further they move away from it, the greater the risk of failure and, ultimately, non-survival. Economic man is guided in his decisions by the maximization of profit. We have already mentioned all this in previous sections. What would now be useful to examine is what profit ultimately is, and how it can undermine other socially desirable objectives and often produce side effects that we did not initially anticipate when forming our intentions.

What is profit? We could distinguish between **monetary profit** and **profit in a broader sense**.

In the financial and accounting statements of companies, as well as in those of businesses and organizations of every size, monetary profit refers to the amount of money available to the business after all relevant expenses have been deducted from its total sales or turnover.[208] The accounting statement used to calculate this profit—or loss—is the **Income Statement**.

This table is an income statement and shows how profit is calculated within a legal entity, such as a corporation.

Therefore, when we speak of profit, we mean **net profit**, because the term could otherwise refer to gross profit, which constitutes the total monetary benefit generated by an investment, a business, or any economic activity, including even a bet or gambling.

Net profit results when the amount spent to undertake the investment—and which is therefore exposed to risk—is deducted from the total monetary benefit.[209]

In the first chapter, when we discussed the philosophy of **Utilitarianism**, we mentioned that what guides human beings is the pursuit of happiness or pleasure and the avoidance of pain.

This inevitably became connected with the pursuit of profit and the avoidance of loss.[210]

Therefore, under conditions of freedom—in other words, in a free market where individuals can engage in voluntary transactions with one another—there is a spontaneous tendency to pursue profit. Theoretically, this appears to be something entirely natural.

Human beings need an incentive to undertake economic activity.[211] What motivates them is profit.

At first sight, this idea appears correct, but I would identify two problems concerning profit:

Problem 1

If someone must always obtain a profit in order to do something, then how can we reverse the ever-increasing trend of income inequality that exists both in Western civilization and globally among different countries?[212]

Problem 2

Second, what are the side effects caused by an exclusive commitment to profit?

Can profit ensure the satisfaction of the most important and essential needs of a society, given that some needs will inevitably be sacrificed?

What are the consequences for social harmony and cohesion?

Does it affect people's moral principles?

Beyond monetary profit, however, we have also referred to a broader concept of profit.

Since profit is connected with feelings of pleasure and satisfaction, which arise from the value of money and the freedom and security that money provides, we can understand that there can also be **non-monetary substitutes for profit**.

In the first chapter, we examined the philosophies of ancient Hedonism and, several centuries later, Utilitarianism.

The Hedonism of Aristippus of Cyrene placed exclusive importance on the pleasures of the body and of emotions and instincts. A similar approach was found in the Utilitarianism of Jeremy Bentham, the second major representative of Utilitarianism. John Stuart Mill, however, attached greater importance to the pleasures of the mind.

This type of profit could become an important motivating force and motivate the independent individual just as effectively, without some of the harmful side effects produced by a market consisting of “shallow”[213] consumers.

The supply and promotion of goods addressed to a more intellectually or morally sophisticated audience is more difficult, both in terms of creating such goods and in terms of effectively promoting them.

This is connected with the second problem we identified earlier, and I will attempt to answer these questions in the next section.

The term “profit” is often used to refer to the compensation received by each factor of production for its contribution to the productive process. Strictly speaking, however, the three factors are distinct and each receives a different form of compensation. These may sometimes become confused, especially when a private individual simultaneously acts as an entrepreneur and

landowner or real-estate owner, while also acting as a worker—for example, in the case of self-employed professionals.[214]

Essentially, every investment or business initiative creates a continuous movement between productive resources—human and material—and final products, which are produced and offered through the productive process. This is the turnover of the business, or, in other words, its sales and total revenues.

These factors of production claim a share of these total revenues and, as we have already seen in previous chapters, when the pursuit of personal profit—or class profit, if you prefer—disturbs the delicate balance between them, the risk of an overall collapse and bankruptcy increases.

As we will see, this can reach the point of affecting the economy as a whole.

On the other hand, when labor is not compensated at its natural level, forms of exploitation emerge, and society is deprived of the necessary labor that would create its wealth.

5.2 Profit vs. Social Welfare: When Maximization Conflicts with Ethical Values

What is the relationship between social welfare and profit?

Various—and often contradictory—views could be formulated.

For supporters of the free market and laissez-faire capitalism, profit is the most effective incentive contributing to the development and prosperity of society.

This view certainly contains an element of truth, because individuals need a personal profit and personal interest in order to undertake any activity. Otherwise, if they contribute to the social or personal welfare of others entirely selflessly, they themselves would become victims of exploitation.

Such a view can be found among liberal economists and philosophers such as Milton Friedman, Friedrich Hayek, Adam Smith, John Stuart Mill, Bernard Mandeville, and others.

However, when the profit motive—which undoubtedly constitutes a rational pursuit for any decent person—goes beyond certain limits, it may result in harm at the level of society and may even lead to worse outcomes for individuals themselves, since it can encourage excessive risk-taking or reduce quality, as in the case of the “lemons” problem.

This happens when relationships are replaced by transactions, as can be seen through a characteristic example from **game theory**, the **Prisoner's Dilemma**.[215]

Two suspected criminals are arrested and interrogated in separate rooms, without being able to communicate with one another.

The police give them two choices:

1. Betray the other person by testifying against them.
2. Remain silent.

In the first case, if both betray one another, they will each receive a sentence of five years.

If one betrays the other while the second remains silent, the first is released while the second receives a sentence of ten years.

In the second case, if both remain silent, they receive a relatively small sentence of one year.

The scenario appears quite realistic and could certainly occur in a real-life equivalent situation.

It is logical that when one person testifies against the other while the second does not, the second receives the greater sentence, provided that their guilt is established, whereas the first is released as a result of having cooperated with the authorities.

On the other hand, if both decide to betray one another, because this reduces their individual exposure compared with remaining silent while the other betrays them, the punishment is five years for each.

The third option, which ultimately maximizes the outcome from the perspective of the whole—something resembling what we might call “social welfare”—is for both to remain silent and receive the smallest possible sentence, since neither accuses the other and guilt cannot be established when the other side does not testify against them.

The alternatives can be summarized as follows:

Choices	Outcome
Both remain silent	Both receive a small sentence (e.g. 1 year)
Both betray each other	Both receive a larger sentence (e.g. 5 years)
One betrays, the other remains silent	The betrayer is released; the other receives a severe sentence (e.g. 10 years)

The Prisoner's Dilemma is a classic example from Game Theory showing how two individuals, even when they are rational and seek what is best for themselves, may make decisions that ultimately lead to a worse outcome for both of them.[215]

An absolutely rational *Homo Economicus* in this situation, applying the basic economic principle, will seek to maximize their benefit at the lowest possible cost.

Therefore, it is in their interest to betray the other suspect while simultaneously persuading the other person to trust them and not betray them—for example, by arguing that if neither betrays the other, they will each receive one year, making two years in total, whereas if one speaks against the other, the total will be ten years: zero for one and ten for the other.

Thinking in the same way, the second suspect will do exactly the same.

As a consequence, both ultimately betray one another and receive five years each, or ten years in total.

By contrast, if there is mutual trust, from the perspective of the whole we obtain the lowest possible total punishment: two years rather than ten in the case where one betrays the other.

The Prisoner's Dilemma therefore provides an example from Game Theory showing that the final outcome can be worse for social welfare when individuals are guided exclusively by their personal interests and the principle of profit maximization.

This often occurs in negotiations as well, where good relationships are extremely important and should not be replaced by transactions concealing cynical intentions.

For this reason, one strategy for effective negotiations is the **strategy of sympathy/empathy**.[216]

Another version of this argument concerns the moral hazard created by excessive risk-taking by financial institutions whose bankruptcy generates side effects for third parties.[217]

The replacement of human relationships by speculative transactions harms social welfare, as the example above demonstrates.

Another practical version of this argument concerns the socially undesirable consequences of the pursuit of GDP maximization.[218]

Two concerns concerning profit therefore emerge indirectly from everything discussed above:

1. **The inequality caused by the pursuit of profit maximization.**
2. **Social needs that are not satisfied by the profit motive.**

I will attempt to provide some brief answers to these two concerns.

First, profit maximization causes inequality.

To some extent, this inequality is socially desirable and useful. It functions as an incentive for people and encourages them to be creative and productive.

Theoretically, profit appears to be a perfectly natural reward for those who contribute to the productive process. Without it, they would not participate in production at all, and the creation and production of real wealth would be reduced.

But if we must always have a profit in order to do something, how can we reverse the tendency toward ever-increasing inequality?

Inequality is useful when it contributes to creation and development. When, however, it appears as the result of unethical practices or is caused by market imperfections, the informal economy, or illegality in general, then it creates a net cost for society without any corresponding benefit.

This problem can be addressed in two ways, either simultaneously or separately.

First, there may be state intervention through taxation of higher incomes and subsidies or support for lower incomes through the provision of public goods that a welfare state is expected to provide. [219]

Alternatively, the market and the individual could be left free to pursue their own interests, without protection from risk and without artificial subsidies or assistance from the state to particular business or private interests.

These two proposals should be applied in combination rather than individually.

If there is absolute equality, individuals lose their incentives and cease participating in the market. This results in lower total income and lower production, to the extent that even an individual person may find themselves worse off than they would be in a society with greater inequality but also greater wealth.

That wealth would precisely result from this inequality and would produce a higher per-capita GDP. [220]

If inequality becomes excessively large, however, per-capita GDP becomes merely a statistical number and does not necessarily represent the actual economic condition of society. It can therefore become misleading.

In such circumstances, the median may be preferable to the mean.

The second alternative to the problem of inequality caused by profit maximization is usually put forward by supporters of the free-market system.

According to this view, the model of perfect competition eliminates inequalities—or at least reduces them—spontaneously, without requiring a central authority to redistribute income.

This redistribution occurs spontaneously because when there is complete freedom and competition, prices tend to move toward their natural levels.

What is required from public authorities is to ensure fair competition so that there is no “non-creative” or “abusive” inequality, if I may use these terms—that is, inequality that does not arise through legitimate means and does not produce any benefit for society by providing a genuine good or service that increases utility without harming others or society.

Particular importance should be given to the phenomenon of **moral hazard**, which occurs when individuals do not suffer the consequences of their actions.

To avoid redistribution of income that equalizes winners and losers and therefore deprives individuals of the incentives they need to distinguish themselves, succeed, and create, there should instead be an alternative financial flow from higher to lower incomes.

In a “society of individuals,” this can be achieved only if there are losses that benefit lower-income groups.

Essentially, there should be a redistribution between winners and losers rather than the elimination of winners and losers.

Therefore, losses must exist, and the state should not intervene to guarantee profits when an investment has failed. Otherwise, the concept of risk loses its meaning.

Only in this way can poorer groups benefit while higher-income groups bear losses, thereby reducing inequality without eliminating the prospect of profit.[221]

The prospect of profit guides individuals, not profit itself. An individual may undertake an entrepreneurial activity because they see an opportunity for profit, and that alone is sufficient, even though the final outcome may be a loss.

What is necessary is that losses should not be the rule and should not be universal, so that there are also winners whom individuals will attempt to imitate.

One practical example is the bond market.

Very often, during a debt crisis, national or supranational authorities—for example, the IMF—intervene and distort the natural processes of the free market by guaranteeing the repayment of interest and principal through compulsory measures.

This creates moral hazard because it encourages investors to behave recklessly when they do not bear the losses resulting from their bad decisions.

At the same time, it blocks the necessary financial flow from higher to lower incomes.

From this perspective, equity financing rather than bond financing may be a preferable method of financing from the standpoint of society, because the investor bears the risk of receiving no dividend if the business fails and reports losses or negative free cash flows.

Second, profit has certain side effects for society.

What succeeds in the market is often socially harmful. Therefore, the commercial success of a product does not necessarily mean that it is genuinely useful or worthy of praise.

Profit is not always capable of ensuring the goods that society needs because some goods do not generate profit. Consequently, no private individual is interested in undertaking their production and supplying them to the market.

For example, in a free market, a product whose consumption increases temporary pleasure may achieve great commercial success even though it may have long-term negative effects on consumers' health.

Examples include Coca-Cola or preferences for foods such as pizzas, fatty foods, and sweets rather than fruits and vegetables.

A similar phenomenon can be observed in television, where subjects requiring thought, concentration, or specialized knowledge are often rejected while lighter entertainment is preferred, sometimes at the expense of the intellectual development of the audience.

We can see the same phenomenon in books, where novels often have greater appeal than scientific books.

Violence, sex, and anything appealing to lower instincts are sufficiently powerful that they tend to prevail over products and activities appealing to higher intellectual or moral capacities.

Therefore, profit not only deprives society of goods that it needs, but can also create goods that harm it.

For this reason, economic activity should not be left entirely uncontrolled.

Before concluding this section on profit, I would like to mention the tendency of profit to guide the economic or business cycle[222] as a particular and distinct side effect of profit.

This has both a positive and a negative impact.

On the one hand, it creates wealth and prosperity.

On the other hand, when greed exceeds the natural rate of profit, it can create destructive tendencies of stagnation and recession accompanied by high unemployment.

If we regard profit as the compensation of labor, as well as of every other factor of production, we can see, for example, that as an economy develops and wages increase, inflationary pressures eventually emerge and make things more difficult for businesses.

At the same time, the share of profit decreases at the expense of the share corresponding to labor compensation.

The economy enters a crisis phase, and many businesses abandon the market, resulting in higher unemployment and lower GDP, which characterizes the recession phase.

At this point, government intervention may become necessary, not to protect consumers but producers, through higher administered prices than those prevailing in the free market.

If unsold inventories emerge, the state may undertake to purchase the unsold goods in such circumstances.

Such state intervention protects the interests of businesses during a phase in which their survival may determine the survival of the market itself.[223]

We will not examine the economic cycle in great detail within the framework of this book. It is sufficient to say that the rate and expectation of profit are crucial to understanding economic cycles.

These cycles produce phases of recession and expansion and have consequences for inflation and unemployment.

5.3 Corporate Social Responsibility and Business Ethics

Profit maximization is the basic objective of businesses according to classical economic theory.

This view is particularly evident in ideologies belonging to the liberal tradition, especially neoliberalism, and is supported by economists such as Friedrich Hayek and Milton Friedman.

Profit maximization becomes the dominant objective of businesses and every investment initiative because the greater the profit, the more secure the survival of the business in an environment of considerable uncertainty, in which the outcome of its actions cannot be predicted with precision and there is always a risk[224] that money will be lost.

For this reason, in finance there is the slogan **“safety first”** when investment decisions are made.

Naturally, the appropriate risk-reward combination depends on the characteristics of the particular investment and on the risk profile of the individual investor.

In large corporations and multinational companies, profit maximization takes the form of maximizing the value of the shares belonging to the owners of the business, as well as the dividends received by those owners and the company's reserves.

This can be achieved by maximizing total revenues and minimizing costs, thereby achieving the highest possible profit.

Depending on how it is implemented in practice, this objective can have either a positive or a negative impact on both society and the business itself.

We will examine this through the views of two important authors: Professor Milton Friedman (1931–2006), recipient of the Nobel Prize in Economics, and Professor Keith Davis (1918–2002) of the University of Arizona.[225]

Theoretically, the pursuit of profit maximization has a positive social impact.

However, this conclusion is reached through a series of assumptions, simplifications, and abstractions from complex reality.

For example, it assumes that people act exclusively on the basis of reason and set aside emotion when making economic decisions, or that they are guided exclusively by profit, individual interest, and self-interest, with no altruistic feelings influencing economic decisions.

This assumption concerning the rational economic human being is not entirely true in every case and is often not true at all.

It would certainly be an overly crude generalization to assume that every person behaves in the same way in the market.

This does not, however, invalidate the usefulness of the assumption, which is partially true because it is based on Utilitarianism, according to which the forces of pain and pleasure are the dominant forces guiding human behavior.

The difference, as we have shown in previous chapters, is that profit is not exclusively money. It may also be associated with non-monetary objectives such as social contribution, social acceptance, esteem, admiration, and so forth.

Within this framework, alternative theories have developed concerning the objective of businesses.

Businesses do not necessarily seek exclusively to maximize profit, or they may not do so directly, because achieving this objective requires providing some value to society or addressing social issues and human needs that remain unsatisfied.

Therefore, if someone seeks economic success, they must offer goods and services of genuine value to the market.

This provision constitutes a form of social contribution.

Such alternative theories can be found in the concepts of **business ethics** and **corporate social responsibility**, which are encountered in modern Business Administration.

Closely related to these concepts are two other ideas that will be analyzed below: **organizational culture** and the phenomenon known as the **agency problem**.

Business Ethics

Business ethics is the branch of Ethics that examines the principles and values guiding the behavior of businesses and the people within them.

It concerns what is right and wrong in the way a business operates.

Business ethics deals with issues such as:

- Honesty in transactions.
- Respect for employees and customers.
- Justice, such as equal treatment.
- Responsibility toward society and the environment.

A company's attitude toward these issues determines the policies it chooses to adopt.

Company policy functions as a kind of internal code that guides individuals toward the appropriate behavior expected of them, based on the wishes of the shareholders and the business ethics they adopt.

Therefore, policy establishes certain social rules, although not rules as strict as those established by law.

Exclusive commitment to profit, the method through which profit is achieved—for example, through offering more competitive products—the preference for quality over quantity or vice versa, return policies, and similar decisions are all examples of business ethics.

A characteristic model of business ethics that has proved successful in practice is **Japanese Management**.

Its success is evident if we consider that some of the most historically sustainable large multinational corporations are Japanese, as well as the scale of Japan's economic success, especially given that Japan was defeated in the Second World War.

What principles shape Japanese Management?

1. Continuous Improvement — Kaizen

Meaning: The process of improvement never stops, even when something is already functioning well.

Objective: Small, continuous changes that lead to high efficiency and quality.

Example: Employees suggest daily improvements to the production line.

2. Teamwork and Group Harmony

Meaning: Success is regarded as the result of a team rather than of isolated individuals.

Objective: Avoidance of conflict, strengthening cooperation and cohesion.

Example: Collective decisions and strong commitment by the group to common objectives.

3. Long-Term Perspective

Meaning: Decisions do not focus exclusively on the profits of the next quarter but on the future of the company.

Japanese management gives priority to the long-term development of the company, often sacrificing short-term profits for future stability.

Objective: Sustainable growth and stable relationships with employees, customers, and suppliers.

4. Continuous Training and Multi-Skilling

Meaning: Employees are trained in several areas so that they remain flexible.

Objective: Better understanding of the production process and greater flexibility in work.

5. Emphasis on Quality — Total Quality Management (TQM)

Meaning: Every employee is responsible for the quality of the product.

Objective: Zero defects, customer satisfaction, and international competitiveness.

6. Employee Participation in Decision-Making — Ringisei

Meaning: Decisions pass through consultation among the different levels of the hierarchy.

Objective: Acceptance of decisions by the entire group and better implementation.

7. Lifetime Employment

Meaning: Historically, companies offered stable employment for the entire working life of the employee.

Objective: Employee loyalty, low turnover, and preservation of knowledge within the company.

Today this practice is applied less rigidly, but it remains an important element of the culture.

Additional importance is given to principles such as:

Lifetime Employment (Shushin Koyo): Traditionally, large Japanese companies offered employment security until retirement, creating strong loyalty and commitment between employees and companies.

Seniority System (Nenko Joryu): Promotions and salary increases are often based on years of service and age rather than solely on performance, thereby strengthening loyalty and group cohesion.

Consensus-Based Decision-Making (Ringi): Decisions are made from the bottom up, seeking the consensus of all parties involved before final approval. This may slow down the decision itself but accelerate its implementation.

Just-in-Time (JIT) Production: A production method aimed at manufacturing the necessary components in the necessary quantity at the exact time they are needed, minimizing inventory.

Quality Circles: Small groups of employees meet regularly to identify, analyze, and solve problems related to their work.

Theory Z: William Ouchi described the Japanese approach as “Theory Z,” combining elements of Western management—such as individual responsibility—with Japanese culture, including teamwork, trust, and concern for employees.[226]

These principles of Japanese Management clearly arise from the business ethics adopted within Japanese culture, which differs from, and is often opposed to, the Western hard form of American-style capitalism that places greater emphasis on individual interest and personal profit.

For example, one ethical principle that could be added to the list above is the emphasis on **personal relationships rather than pure transactions**.[227]

This is a distinctive principle that demonstrates the difference between the two markets.

Although both are free markets, the different cultures of the peoples involved make them appear different.

Naturally, the intensity of international competition often forces countries to make certain compromises concerning the principles they would ideally like to follow in order to survive in an increasingly competitive modern environment.

The way in which a company chooses to motivate its employees is also connected with the business ethics it adopts.

Whether it chooses to reinforce a particular behavior through monetary or non-monetary incentives, whether it uses rewards or punishments, and the type of leadership it chooses to follow all arise from the ethical framework adopted by the business.

These principles are part of what we call **corporate social responsibility**.

As we have shown earlier, the only objective recognized by mainstream economic theory and by hard-line ideologies centered on the free market, such as neoliberalism or certain aspects of anarcho-capitalism, is profit maximization.

If individuals are left uncontrolled and free to pursue this objective, according to classical liberals such as Adam Smith, they may, without this being their immediate intention, achieve a different objective from the one they originally intended.

This could be called the **public interest**.

If, however, human beings are selfish, self-interested, or "bad" by nature, they may not display altruism and may be concerned almost exclusively with their personal interest and profit.

For precisely the same reason, however, they will seek to limit the competition that pressures them to reduce their profit margins and to limit the obligations imposed upon them by legislation, which may similarly restrict their profits.

This leads to the formation of a market that does not take the form of a perfectly or fully competitive market but rather of **monopolistic competition**.[228]

This restriction of competition can be achieved through cooperation among established companies that do not want to see a new competitor enter the market and claim a share of it.

Often, for this purpose, they are able to secure government support through measures such as bureaucratic and regulatory barriers or taxation, such as tariffs that restrict foreign competition.

In this way, they achieve their objective and limit competition, securing a higher profit margin for themselves.

These market imperfections lead to a different situation and an environment different from the one assumed by economic theory through its simplifications.

This consequence of the one-sided application of the profit-maximization motive contributed to the development of movements against businesses, multinational corporations, and the financial sector and contributed to the emergence of the concept of **corporate social responsibility**, in order to address the negative effects of profit on society.

Corporate Social Responsibility

By **Corporate Social Responsibility (CSR)** we mean the policy and sensitivity of a business toward issues affecting society as a whole.

Corporate Social Responsibility is the obligation of a business to operate in a way that does not focus solely on profit but also takes into account its effects on society and the environment.

It means that a company cares about the world around it, not merely about its money.

It is important because it improves the company's image, creates trust with the public, and contributes to a more sustainable society.

Corporate responsibility covers several areas:

- **Environment:** reduction of pollution, recycling.
- **Society:** support for vulnerable groups, donations.
- **Employees:** good working conditions, fair wages.
- **Ethical operation:** transparency and authenticity in business practices.

More specifically, it may include:

- The production of recycled products or the use of raw materials derived from recycled materials.
- Organizing the production process through techniques that respect and protect the environment from pollution. Many businesses install special filters to control pollutants or use technology that reduces gas emissions.
- Training managers with an emphasis on environmental respect. In this case we speak of “green managers.”
- Various social benefits for employees, such as children's camps, staff excursions, discount coupons, benefits in kind, and various gifts.
- Programs for employee welfare.
- Various benefits to society as a whole, such as blood donations, humanitarian assistance, support for fundraising campaigns, and similar actions—for example, a company making donations to schools or hospitals.[229]

At this point, it would be particularly interesting to present two perspectives on the issue of corporate social responsibility, and I would prefer the reader to draw their own conclusions regarding the appropriate balance of the social role that should guide businesses. At the beginning of this section, we referred to Professors Milton Friedman and Keith Davis. From the former, we will examine arguments against corporate social responsibility, while from the latter, arguments in favor of it:

Corporate Social Responsibility

The relationship between business activity and social responsibility is a long-standing issue in business management. The fundamental question is whether a business should limit itself to its economic mission and compliance with the law, or whether it should also take broader social needs and consequences into consideration.

Two characteristic and contrasting approaches to this issue are associated with Milton Friedman and Keith Davis. Friedman views the business primarily as an economic organization, whereas Davis places greater emphasis on its broader social impact.

The Limited View of Social Responsibility

According to Milton Friedman's approach, the primary responsibility of managers is to manage the firm's resources in a manner that creates economic value for its owners and shareholders, always within the limits of the law and the rules of competition.

From this perspective, undertaking social initiatives using company resources may create a problem: managers are using money that does not personally belong to them for purposes that they themselves consider socially desirable. At the same time, social objectives are not always easy to measure with the same precision with which financial results can be evaluated.

Another argument is that systematic financing of social programs may increase a firm's operating costs. If these costs are passed on to consumers through higher prices for products or services, the firm's competitiveness may be affected. Furthermore, business management does not necessarily possess the expertise required to determine which social problems should be addressed and what the most effective way of addressing them would be.

This approach does not mean that business activity is socially irrelevant. A business that operates efficiently can create employment, produce goods and services, pay taxes, and contribute more generally to the creation of economic activity. In this sense, socially beneficial outcomes may arise as a consequence of the firm's economic operations without necessarily constituting its primary objective.

The Broader View of Social Responsibility

A different approach is associated with Keith Davis. From this perspective, businesses are important social institutions, and the power they possess entails corresponding responsibilities. Their decisions affect employees, consumers, local communities, the environment, and society more broadly.

Therefore, a business does not necessarily have to wait for government intervention or the introduction of new legal obligations. When it possesses the necessary knowledge and capabilities, it can take initiatives to address social problems.

This approach may also serve the interests of the business itself. A company that contributes to improving the social and economic environment in which it operates may, in the long term, create more favorable conditions for its own development. For example, investments that reduce environmental impact may, in some cases, simultaneously reduce operating costs or strengthen the company's reputation.

At the same time, addressing social problems at an early stage may prevent them from developing into more serious situations that would later require greater financial or institutional intervention. Social responsibility may also strengthen the trust of consumers and society in the business.

Different Levels of Social Responsiveness

Social responsibility is not implemented in the same way by all businesses. We can imagine a continuum that begins with strict compliance with existing obligations and extends all the way to active participation in addressing broader social issues.

At the first level is **compliance with legal obligations**. The business limits its social responsibility to what is required by the institutional and legal framework. Its primary priority is lawful and economically sustainable operation.

At a second level, the business goes beyond simple compliance and undertakes initiatives that are directly related to its activities or that may simultaneously generate business benefits. Social action is therefore more closely connected to the firm's long-term strategy.

At the most comprehensive level, the business considers social needs that may not directly affect its day-to-day operations. It may undertake initiatives concerning issues that it believes will become more important in the future or cooperate with other social organizations in addressing them.

What Is the Appropriate Degree of Social Responsibility?

There is no single answer that can be applied to every business and every period. The appropriate degree of social responsiveness is influenced by the size and nature of the business, the industry in which it operates, the needs of society, the institutional environment, and economic conditions.

A business operating in an industry with significant environmental or social impacts may have different responsibilities from a business operating in an entirely different sector. Similarly, the social priorities of one country or period may differ considerably from those of another.

The essential issue, therefore, is not simply whether a business should be socially responsible, but **to what extent, by what means, and according to what criteria it should undertake social initiatives**. The balance between economic efficiency and social contribution ultimately represents a choice that each business must address within the specific circumstances in which it operates.[1]

The optimal degree of social responsiveness is not so easy to determine and depends on the historical circumstances and the political and social conditions within which businesses operate. The reader may draw their own conclusions.

Before concluding this section, I would like to mention two phenomena to demonstrate that extreme positions would constitute a distortion and that the optimal choice would probably be a combination of the approaches described above.

These are:

1. The weaknesses of GDP within the framework of macroeconomic policy.
2. The agency problem.

The Limitations of GDP

GDP is the measure used to calculate the value of total production in monetary units within an economy.

It is used to draw conclusions concerning the economic welfare of a society and therefore its general well-being.

It is such an important measure that the success or failure of economic policy and governments is now often judged according to it.

The maximization of GDP for the economy as a whole is analogous to the maximization of profit for an individual business.

Although GDP appears to provide a measure of welfare, there are weaknesses in the way it is calculated.

These weaknesses can support the argument that exclusive commitment to profit can ultimately become harmful even to the business or state itself.

I will not examine all the weaknesses of GDP here. I will focus on three:

1. **It ignores the composition and distribution of the output produced.**
2. **It is a quantitative rather than a qualitative indicator.**
3. **It ignores the activity belonging to the informal economy.[231]**

This means that GDP measures only monetary values and does not show the particular type of goods produced and supplied or whether those goods are distributed equally or unequally.

For example, if a war occurs and the production and supply of weapons increases, this appears positive from the perspective of total income, whereas in reality it may be disastrous for society.

Another example is factories and industries that pollute the atmosphere and damage the environment. They generate an increase in income, but they simultaneously destroy the environment.

This consequence is not visible anywhere if we judge only by GDP.

GDP measures expenditure, but it does not necessarily tell us whether the expenditure contributes to genuine human welfare.

Second, GDP ignores quality because quality is often not reflected in price.

Yet quality is extremely important for social welfare.

If we compare a low-quality product with a high-quality product, we can understand the difference.

If quality does not generate profit, there may even be products in the market that are dangerous to human health.

Finally, with regard to the informal economy,[232] it is particularly relevant to examine it in connection with the pursuit of profit maximization by businesses, since this pursuit may encourage illegal activities or profiteering that produces high profits.

In a similar way, excessive commitment to profit can be harmful to society because it may encourage individuals to engage in irresponsible or illegal high-risk activities that have side effects for third parties, or in activities that generate high profits without considering their harmful and parasitic effects on society.

The quality of goods and services offered may also decline.[233]

If we judge all these phenomena together, we might conclude that the pursuit of profit is an objective that should be ignored.

However, that would be mistaken.

What matters is the perspective from which profit is judged.

Let us demonstrate this through an example: the **agency problem**.

The Agency Problem

The agency problem describes a phenomenon observed in businesses, although it can also be examined in politics and sociology.

In business, it refers to the problem that arises when the management of a company, provided that the managers are not themselves the shareholders, places their own interests above those of the owners of the company whom they are supposed to represent.

These are cases involving a conflict of interests in which senior managers—such as the chairman or chief executive officer of a company—charge personal expenses to the business while disregarding the company's profits and the value of shareholders' wealth.

This phenomenon can reveal two different sides of the pursuit of maximum profit.

If we judge it from the perspective of the personal profit of the managers, we would regard it more as theft, extraction of private benefit, profiteering, or fraud.

If, however, we judge it from the perspective of the personal profit of the company and its shareholders, we would say that maximizing profit is ethically correct.

Let us recall that, for Friedman and his neoliberal followers, profit maximization means maximizing shareholder wealth.

This should be the objective shaping the business ethics and culture of managers and employees, rather than their personal enrichment at the expense of the company's profits.

Therefore, the idea of profit depends upon the particular circumstances under which we judge the pursuit of profit and upon the individuals involved.

The agency problem can also be observed in other fields, such as politics.

There, it refers to the corresponding phenomenon in which politicians place their own interests above those of the people whom they are supposed to represent.

We could compare politicians with corporate managers and shareholders with the people, to whom the state theoretically belongs.

This concludes the discussion of the limits of profit within the present chapter.

---

[207] Some characteristic representatives of this idea were John Maynard Keynes and John Rawls.

[208] These expenses can be grouped into many categories, but it would not be meaningful to provide a complete list within the framework of this book. The most important are operating expenses relating to employee compensation or payments for third-party services, as well as expenses for the maintenance of fixed and current capital.

[209] Free cash flow is the money that remains after a company has covered its investments (CAPEX). For a more detailed assessment of profits, free cash flow is often examined rather than simply the income statement, because the latter may contain accounts that can be misleading. Cash is more “real” than accounting profits.

[210] Hence the term *loss aversion* in behavioral finance and the reason why it constitutes a spontaneous reaction of human nature. This aversion also makes human beings averse to risk—*risk aversion*. There is no profit without risk, however, which is why the pursuit of profit acquires a strategic character. A reckless one-sided commitment to profit that fails to take potential risk into account may itself become a factor of economic failure.

[211] This is also the definition of economic activity: it should aim at obtaining some benefit or return. It should not be undertaken merely for self-consumption, although self-consumption could itself be regarded as a form of profit in a certain sense.

[212] Inequality can sometimes be greater—and indeed is greater—in countries that theoretically reject the pursuit of profit as an ethical principle of behavior and attempt to restrict it. This occurs because the tendency is impossible to restrict, since it constitutes a very powerful force of human nature, and every attempt to restrict it simply becomes a source of corruption and profiteering rather than healthy competition and the pursuit of profit.

[213] Consumers who do not possess substantial values or deeper interests and who are not conscientious regarding the ethical quality of the various services and products available in the market.

[214] Smith, Adam. *The Wealth of Nations*, 1776.

[215] The Prisoner's Dilemma is a classic example from Game Theory showing how two individuals, even when they are rational and seek what is best for themselves, may make decisions that ultimately lead to a worse outcome for both of them.

[216] See the “lemons problem,” discussed in Section 4.1.

[217] See Section 4.2.

[218] GDP (Gross Domestic Product) is one of the most important measures in economics and indicates how much economic activity is produced within a country over a given period, usually one year. GDP is the total value of all goods and services produced within a country and, in public finance, constitutes a measure analogous to profit for an individual business or private person.

[219] This can also be achieved through voluntary actions undertaken by civil society or through volunteering.

[220] Per-capita GDP means Gross Domestic Product per inhabitant. GDP is the total value of all goods and services produced in a country during one year. It is obtained by dividing a country's total GDP by its population and therefore shows the average GDP corresponding to each inhabitant. It is an average and, as such, is vulnerable to unrepresentative measurements when extreme inequality tends to increase the mean. In such cases, the median may be preferred to the average. The median in statistics is the middle value of a dataset when the observations are arranged in ascending or descending order. For example, if we have wages/incomes of €700, €750, €800, €850, and €5,000, the average rises substantially because of the €5,000 income. The median, by contrast, is €800, which better represents the typical wage.

[221] The prospect of profit guides individuals, not profit itself. An individual may undertake an entrepreneurial activity because they see an opportunity for profit, and that alone is sufficient, even though the final outcome may be a loss. What is necessary is that losses should not be the rule and should not be universal, so that there are also winners whom individuals will attempt to imitate.

[222] The economic cycle refers to recurring fluctuations in a country's economic activity over time. In simple terms, the economy sometimes grows and at other times slows down or contracts. These phases constitute the economic cycle. It is usually measured on the basis of Gross Domestic Product (GDP).

[223] Lianos, Theodoros; Papavasileiou, Antonios; Chatziandreas, Andreas. *Principles of Economic Theory, 3rd Grade of General Lyceum: Elective Course*. “Diophantos” Publications, 2000.

[224] Risk means a known probability of losing money; therefore, it is inevitable that some individuals will fail and lose money.

[225] Keith Davis lived approximately from 1918 to 2002, although there are minor differences among sources concerning his exact year of birth. He was an important theorist in business administration and particularly in

organizational behavior. Milton Friedman lived from 1912 to 2006. He was one of the most important economists of the twentieth century, known for his ideas concerning liberalism and monetary policy.

[226] In sociology and management, culture refers to the set of values, beliefs, perceptions, and behavioral norms shared by members of a society or organization. It includes ways of thinking, communicating, making decisions, and resolving conflicts. It may be national culture, such as Japanese or American culture, or corporate/organizational culture, such as that of Google or Toyota. Here we are referring to organizational culture within the field of management. Culture is connected with business ethics, and the relationship between them is reciprocal.

[227] See Game Theory and the Prisoner's Dilemma.

[228] See Chapter 2.

[229] Vaxevanidou, M. and Rekleitis, P. *Principles of Organization and Business Administration, 3rd Grade EPAL*. "Diophantos" Publications, 2020.

[230] Montana, J. Patrick and Chavron, Bruce H. *Management*. Barron's Educational Series Inc., U.S., 2015.

[231] Lianos, Theodoros; Papavasileiou, Antonios; Chatziandreou, Andreas. *Principles of Economic Theory, 3rd Grade of General Lyceum: Elective Course*. "Diophantos" Publications, 2000.

[232] The informal economy is the totality of economic activities carried out outside the official—legal and declared—economic system of a country. Put more simply, it consists of money and transactions that are not declared to the state and are therefore neither taxed nor recorded in official statistics.

[233] See the "lemons problem."

CHAPTER 6 — JUSTICE IN THE DISTRIBUTION OF RESOURCES

6.1 The Subject Matter of Political Economy

The profit motive is the vehicle of development, and in earlier periods its contribution was particularly important. It managed to bring humanity out of the dead end of the Malthusian trap[234] and contributed to the prosperity and wealth that exists around us.

In the modern era, however, there is market saturation and there is no longer sufficient available land and natural resources—factors of production—to sustain the same rates of growth that existed in the past. The profit motive now creates a kind of suffocation in society, caused by the intense pace of life, excessive competition, excessive population growth, inequality, and so forth, which constitute some of the main side effects of profit on society.

In this section, we will focus on this problem, which is related to one of the fundamental questions addressed by economics.

In the second chapter, we presented the dominant economic theory and the basic questions and models used within it. The fundamental problem that economics attempts to address is the scarcity of productive resources in relation to the unlimited needs of human beings, which are not subject to definitive saturation.

From this fundamental problem arises the subject matter of economics. It would therefore be useful to recall once again what constitutes the subject matter of political economy.

If we return to the second chapter, we find the following passage:

> “The basic economic problem gives rise to four questions that every economic system must answer, and the different way in which each economic system approaches these questions constitutes the criterion by which we characterize a system as capitalist or socialist/communist. These questions essentially constitute the subject matter of political economy:
>
> 1. What products are produced and in what quantities? (within a unit of time)
> 2. How are they produced?
> 3. For whom are they produced? (That is, how are they distributed among the members of society?)
> 4. How will the economy develop?”

In this section, we will focus on the third question, namely the distribution of goods.

In Chapter 2, we mentioned that there are two alternative approaches regarding the distribution of the economic product:

1. Distribution from the top downward.

2. Distribution from the bottom upward.

1. Distribution from the Top Downward

This may take the form either of income redistribution from the richer to the poorer through state intervention, with public expenditure by the state to support certain incomes and corresponding taxation of other incomes—obviously higher incomes, in order to achieve redistribution—or it may take the form of what is known as **“trickle-down”**, without the need for intervention by state authorities to achieve this outcome.

The first case, redistribution through the state, requires intervention through expenditure and taxation in order to strengthen lower incomes so that other social groups can have access to sufficient purchasing power to secure what is necessary for meeting their basic survival and social needs.[235]

These expenditures may either take the form of transfer payments, that is, simple transfers of money without productive activity or the creation of wealth, such as pensions and benefits, or they may concern the provision of public goods, namely the production and supply of real economic goods by the state to satisfy collective social needs.

These goods appear to be provided free of charge, since the cost of providing them does not directly burden the recipients of the benefit generated by the good.

In this case, transactions from the top downward are obviously not mutually beneficial, since one income group pays taxes while another receives them. A moral hazard therefore exists because these transactions, or income redistribution, are neither voluntary nor spontaneous, but are the result of central planning within a centrally controlled economy.

However, a centrally controlled economy has the advantage that it can better determine which social groups ultimately receive assistance and which incomes ultimately bear the burden.

An alternative proposal for redistribution, without the need for state intervention through coercive measures—which always constitute a form of oppression of the individual and of freedom—is the so-called **“trickle-down”** approach, which is related to distribution from the bottom upward. For this reason, I will discuss the two concepts together.

2. Distribution from the Bottom Upward

At first sight, it may seem paradoxical for distribution to take place from lower to higher incomes. This, however, is the tendency that we observe in many economies, particularly free-market economies.

What distinguishes a centrally controlled economy from a free-market economy is the ownership of the means of production.

In centrally controlled economies—of the socialist or communist type—the means of production are owned and controlled by the state through special legislative arrangements. The government appoints the executives who manage the organizations it owns, or it may exercise control and influence through regulations imposed on privately owned businesses.

The theoretical objective of the government is to promote the public interest directly.

By contrast, a free market is associated with the economic system of capitalism. Under capitalism, the means of production are privately owned, by individuals or private entities, or their management is carried out by private individuals.

In this case, the objective of private individuals is to maximize their profits or whatever other non-monetary benefit they personally desire, and the public interest may be achieved indirectly, as a consequence of the original intentions of private individuals.

“Individual ambition/self-interest serves the common good,” says the Scottish philosopher and economist Adam Smith.[236]

This ethical principle and the economic policy it favors are connected with distribution from the bottom upward and with the policy of trickle-down that we examine below.

In a free market, individuals are guided by the profit motive. The profit motive proves to be much more effective than the coercive motive of government policy if we consider the amount of wealth created by Western-style liberal capitalist economies compared with the stagnation observed in statist economies.

When individuals are left free to pursue their personal profit, this becomes the spearhead of development. It is not, however, without side effects, since the price of this development is continuously increasing inequality.

Inequality, particularly economic inequality, is a very important issue that makes the basic economic problem appear worse and become more severe. It creates poverty and hunger both domestically and internationally.

It directly conflicts with fundamental human rights and the principle that we are all born equal and deserve equal rights and freedoms, because, inevitably, the economic factor determines these rights and freedoms.

The effort to achieve equality—or at least to reduce inequalities to the greatest possible extent—is connected with the so-called **trickle-down policy**.

This refers to a strategy or policy that attempts to ensure that the economic or social benefits arising from the development, progress, or growth of a country or society reach the lower social classes or the most vulnerable groups of the population.

This term is often associated with the redistribution of wealth or with policies aimed at reducing social inequalities.

Rather than concentrating benefits exclusively among the upper classes or large corporations, “trickle-down” means that benefits should reach the poor, workers, or those who have fewer opportunities.

This is not achieved through redistributive fiscal policy, but through an attempt to eliminate market imperfections.

As we recall from Chapter 2, a perfectly competitive market forces each side to reduce its profit margins to such an extent that, even if equality is not achieved, the resulting inequality may be considered a **fair inequality**.

The objective of this strategy is to reduce inequalities and strengthen social cohesion by creating a fairer and stronger society.

Some ways in which this may be achieved include:

- Increases in workers' wages or improvements in working conditions.
- Social welfare programs, such as unemployment benefits and support for low-income individuals.
- Investment in education and training in order to provide people with greater opportunities for advancement.
- Tax policies that place a greater burden on wealthier groups and redistribute revenues toward social services and infrastructure for poorer groups.

The theory argues that the benefits of economic growth or tax reductions for businesses and wealthy groups will eventually "trickle down" to lower classes through increased investment and job creation.

However, this approach has often been controversial because it does not always guarantee that the benefits will reach those who need them most.

Earlier, we referred to the idea of **fair inequality**. At this point, it would be worthwhile to mention the great twentieth-century philosopher **John Rawls**, whom we will examine in greater detail in Section 6.3.

John Rawls is known for his works *A Theory of Justice* and *Political Liberalism*. As a political theorist, he belongs to the liberal tradition and to what we call **social liberalism**.

His theory concerning income distribution is connected with the idea of trickle-down. We will examine this issue in greater detail in Section 6.3.

6.2 Freedom vs. Equality

Why, then, do economies choose redistribution from the bottom upward when the price is continuously increasing inequality?

The answer is that there are economies that are based either on **freedom** or on **equality** as the fundamental moral principle and objective of their policies.

When one believes in the principle of freedom, it is not possible to restrict inequality—or to impose equality—as effectively as when equality is regarded as the absolute objective of political policy.

I will attempt to connect this section with the schools of ethics examined in the first chapter.

The objective of equality in a socialist economy can be achieved more easily because such systems adopt a consequentialist ethic of the type **"the end justifies the means."**

By contrast, the political economy of freedom is, or ought to be, more closely associated with virtue ethics and deontology/duty and does not accept the maxim "the end justifies the means."

This means, of course, that oppression, restriction of freedom, and state paternalism—which constitute the means—are not considered worthwhile simply for the purpose of achieving equality.

State intervention is always a potential threat to individual rights and freedoms.

On the other hand, a supporter of equality and socialism could argue that the free market is connected with consequentialist ethics, since this tendency is inherent in human beings and becomes dominant under conditions of freedom.

Moreover, the models we examined in Chapter 2, such as the economic principle of cost-benefit comparison and the model of the rational *Homo Economicus*, are theoretically based on the philosophical idea of **Utilitarianism**.

For this reason, in order not to fall into the trap of unintended side effects, I would like to recall some words of Nobel Prize-winning economist Milton Friedman:

> "One of the great mistakes is to judge policies and programs by their intentions rather than their results."

Although this statement was made by a liberal economist, it could also serve as an argument for a supporter of equality and the welfare state.

Let us examine how this position can be applied and interpreted in the two types of societies described above, whose differences also imply different types of political economy.

Freedom

Under conditions of freedom, the state does not intervene in the economy because it considers it morally inappropriate to force individuals to assume tax obligations on income that belongs to them.

It also considers it equally inappropriate for certain groups of the population that do not genuinely contribute something to the economy or society to become recipients of assistance.

If we finance unemployment and poverty, then it is as though we are following a policy that reproduces unemployment and poverty, while simultaneously punishing the economic activity of people who are trying to succeed and create.

Under conditions of freedom, the four basic questions that constitute the fundamental subject matter of political economy are addressed differently and lead to the formation of a different economy and society compared with statism and equality.

These questions arise from the fundamental economic problem itself and constitute the subject matter of economics, or political economy.

As we saw both in Chapter 2 and in the previous section, these questions are:

1. What products are produced and in what quantities? (within a unit of time)
2. How are they produced?
3. For whom are they produced? (How are they distributed among the members of society?)
4. How will the economy develop?

In the natural condition of absolute freedom, the economic system of **capitalism** is formed, and specific answers are given to these questions.

Let us examine them one by one, considering both their positive and negative aspects and why state intervention may ultimately be necessary.

1. What products are produced and in what quantities?

In a free market, the state does not decide how the country's available capital will be used or what products will be produced. These decisions are made by individuals, who own the country's capital.

The individual is free to decide with the objective of maximizing profit, which will provide additional capital and thereby enable the business to survive.

The fundamental issue here is how each political-economic model determines value.

“Without utility there is no value,”[237] Karl Marx tells us.

Utility or benefit may arise from two forces:

1. Pleasure.
2. Pain.

The objective of maximizing utility may often require the sacrifice of pleasure in order to avoid greater pain later. This is what a truly rational individual would do.

In the free market, however, the individual acts on the basis of their own knowledge. They possess neither perfect knowledge nor the ability to set aside emotion and think exclusively according to reason.

These assumptions are unrealistic, or at least not realistic to the degree assumed by economic theory.

This is one of the reasons why state intervention may be required, as we will see below.

However, this solution also involves risks, because in this case theory does not completely correspond to reality either, and unrealistic assumptions also exist.

Returning to the question of value, a free market assigns value to goods that maximize utility and pleasure.

We therefore observe intense production and availability of goods that satisfy our basic instincts and passions, namely physical pleasures arising from our fundamental needs.

This happens because, in the market, producers and businesses must attract consumers and persuade them to purchase voluntarily.

This can be achieved only through improved competitiveness.[238]

However, how we judge quality is subjective.

In a free market, there may therefore be significant consumption of goods of little or inferior quality, provided that these are what the public desires and what businesses produce and offer.

By contrast, the supply of higher-quality goods may impose an economic cost on the business or entrepreneur.

This resembles the political cost that politicians face when they are required to provide goods that are not recognized by society but may nevertheless be necessary according to other criteria.

For example, a free market may encourage unethical productive activities that pollute the environment or impoverish sections of the population because the final product generates substantial profit arising from the high pleasure or satisfaction produced by the good.

This pleasure may conceal an equal amount of pain, which is not immediately visible and therefore does not receive an equivalent response in a system that simply measures economic profit.

For example, Coca-Cola has been criticized at various times for allegedly engaging in unethical practices. It has been accused of promoting soft drinks, particularly to children, without fully communicating the health consequences of high sugar consumption, such as obesity and diabetes.

With regard to labor practices, there have been allegations in some countries, particularly during the 2000s, concerning intimidation, harassment of workers, or restrictions on union organization.

There have also been allegations concerning labor-rights violations in factories in developing countries.

The company has also been criticized for excessive water consumption in regions where access to clean water is limited, as well as for allegations of pollution or inadequate waste management by factories.

This example is not unique.

A similar case concerns **Johnson & Johnson (J&J)**. The company was accused of its baby powder containing traces of asbestos and of its use being associated with ovarian cancer or mesothelioma.

Tens of thousands of lawsuits were filed in the United States, with some courts awarding billions of dollars in damages.

Johnson & Johnson has maintained that its products were safe, but in many cases it has paid compensation or entered into settlements.

Many such examples can be found, but there is no point in extending the discussion here.

It is sufficient to say that multinational corporations and financial institutions often generate such externalities, and this is a phenomenon that can occur under the natural condition of freedom.

It should nevertheless be noted that similar harm to the environment or to third parties can also be caused by a public enterprise or organization, such as a public hospital.

Furthermore, in a free market, the quality and satisfaction of higher intellectual and moral needs may be downgraded.

As we recall from Maslow's hierarchy of needs,[239] it is more difficult for a person to develop these higher needs, and therefore a smaller percentage of the population is guided by the desire for quality, education, rationality, improved health, and the meaningful goods of life.

Under conditions of freedom and in a free market, this smaller proportion of the population will generate correspondingly lower profits, since the overwhelming majority does not choose to acquire such goods.

For example, novels may be preferred to scientific books by publishers and the public, or films and television series may promote violence, crime, exploitation, and similar themes because they appeal to our passions and animal instincts, which are much stronger than the higher human and rational faculties and therefore generate greater profits.

In an economy of freedom, therefore, we may observe a stronger presence of consumer goods, such as automobiles, luxury real estate, and clothing, compared with the goods observed in different types of economies that place greater emphasis on equality.

We will examine the latter case in greater detail below.

2. How are products produced?

Under conditions of freedom, the criterion is profit maximization.

Therefore, whatever is produced will be produced with the minimum possible amount of labor and at the lowest possible cost, while simultaneously seeking the maximum possible quantity of output.

Consequently, there may be mass production and extensive use of advanced technology, which leads to a significantly higher level of wealth.

The cost, however, may be **structural unemployment**, caused by the use of new technology and by the need to develop new specialized occupations.

Unemployment is also caused by the reduction in labor costs resulting from the use of this technology.

For example, in Western capitalist economies, a significantly smaller proportion of the labor force is employed in the primary sector than in so-called Third World economies.

For example, approximately 3% of the labor force is employed in the primary sector in France, compared with approximately 41% in Nigeria.

This is achieved through more efficient technology.

Therefore, in a free economy we expect to see a reduction in costs through the use of new technology, which may lead to higher unemployment rates as well as stronger demands for maximizing productivity.

3. For whom are products produced?

The mechanism of distribution under conditions of freedom differs from the corresponding mechanism under conditions of equality.

The spontaneous tendency of human beings under conditions of complete freedom is to seek to maximize personal profit.

By contrast, in a society that gives priority to social values such as equality or the distribution of resources, this spontaneous tendency toward inequality is subject to redistribution through state intervention.

In liberal economies, the means of production are owned or controlled by private individuals and entities, either partially or entirely, since in practice economies are mixed and ownership of businesses often belongs simultaneously to private individuals and the state.

In centrally planned economies, by contrast, the means of production belong to the state or are regulated and supervised by the state to such an extent that their operation is directed according to its objectives.

The objective of the private individual is profit maximization, while the state is more concerned with income equality and justice in the distribution of resources.

The concept of justice, however, is subjective, and philosophers and economists do not all regard the same things as just.

In a centrally planned economy, equality may exist, but at the cost of reducing the wealth generated by the profit motive.

There is also significantly less interest in property that does not belong to a specific owner but to society as a whole in an abstract sense, and this affects the quality of services.

This is why privately owned buildings and offices are often found in much better condition than those belonging to public organizations.

A characteristic example is public schools compared with private schools.

In public institutions, there is no genuine individual interest in property that does not belong to a specific person.

By contrast, in a private school, the property belongs to an individual who has every reason to care about its protection, since it constitutes capital that generates income and profit.

As a final conclusion, we could say that in societies of freedom we have distribution from the bottom upward, followed by the trickle-down of benefits through the attempt to establish a perfectly competitive market that leads spontaneously to equilibrium, an idea related to equality.

A similar idea is formulated by the political philosopher John Rawls in his work *A Theory of Justice*, and we will examine this idea in Section 6.3.

4. How will the economy develop?

Finally, an important question for economies concerns how they will develop in the long term.

Within the framework of the free market, this improvement is achieved through **capital accumulation**, which means investment in productive labor that creates added value on the raw materials it processes.

This is contrasted with services which, although they have value, do not create added value and therefore could not be considered productive labor.[240]

This tendency toward capital accumulation ensures sustainability, but it is also a factor that gradually aggravates inequality.

Equality

An economy based on the social value of equality, in contrast to the social value of freedom, assigns ownership of its capital to the state.

Individuals therefore possess little or no private property compared with liberalized economies, although even where property belongs to private individuals, the presence and regulation of the state may be significant.

The answers provided by a centrally planned economy to the four questions above are obviously different.

For example, regarding the first question, we would expect the presence of different types of goods.

We might expect hospitals instead of casinos, or facilities for receiving migrants instead of theaters.

We would also expect economic activities with adverse effects and side effects on society to be prohibited, such as activities that promote violence and crime through television or electronic games.

This follows from the fact that in such a socialist society the profit motive is significantly weaker.

Therefore, production and supply are not primarily directed toward products that generate significant profit, but toward products and services that satisfy important social needs.

This occurs because, in a socialist economy, survival does not depend upon accumulating profits and increasing capital.

There is no such risk because all businesses belong to the state, which can collect whatever financial capital and labor it considers necessary from its citizens in order to support the domestic economy.

Second, concerning how products are produced, we would expect less use of technology that threatens jobs, in order to maintain full employment of the labor force that contributes to the creation of income and economic independence.

This would constitute a cost for a private individual, but for the state it is an easily manageable cost.

Nevertheless, the economy cannot avoid the cost arising from lower productive capacity due to the failure to use new and efficient technology.

Centrally planned economies therefore have a significant disadvantage concerning production costs and competitiveness, which ultimately means a significantly lower level of wealth.

Third, there is the issue of income redistribution.

Here, redistribution takes place from the top downward and may range from simply reducing inequalities to complete equality.

Although complete equality may theoretically appear perfectly fair and humanitarian, in practice it has proved problematic and has led to the collapse of economies, with chaotic consequences for society and the political system itself.

Here Milton Friedman's words are relevant: in attempting to guarantee income for everyone, the state may deprive individuals of the incentives they need, resulting in economic stagnation.

Moreover, the very existence of such a powerful force as a large state constitutes a threat to freedom in itself, and there is no one who can guarantee that such a powerful state will not abuse its authority.

Finally, with regard to long-term development, there appears to be a preference for the short-term horizon rather than the long-term one.

This may be due to the fact that governments have limited terms of office and therefore have less interest in the consequences of their policies in the distant future, when they will in any case have lost political power.

This may have negative consequences for the future of an economy, since a long-term horizon is extremely important in economics.

At the same time, however, we would expect a lower tendency toward capital accumulation, which gradually generates inequalities.

In general, these are some of the basic characteristics of an economy based on freedom and an economy based on equality.

In the first case, the means of production belong to private individuals, while in the second they belong to a centrally planned authority.

The reader is free to draw their own conclusions from the presentation of these ideas and arguments.

Personally, I would say that each type of society has positive and negative elements, and that a **middle ground between the state and the market** should be found. We will examine this issue again in Chapter 7.

For the time being, it is sufficient to say that in practice economies are mixed. That is, they contain a mixture of free-market mechanisms and state intervention. In free-market economies, we observe the existence of certain basic public goods and a minimum necessary level of state intervention, even if only outside the economic sphere.

At the same time, centrally planned economies also contain private property, stock exchanges, and economic freedom. An important attempt to combine equality and freedom can be found in the work of the great twentieth-century political philosopher **John Rawls**.

6.3 The Optimal Distribution According to John Rawls

As the reader will have noticed, we operate within the liberal tradition and the dominant ideology of Western civilization.

The purpose of this work is to encourage reflection and propose new alternatives that will help improve the system of natural liberty rather than completely overturning and replacing it with absolute government intervention.

Instead, we will examine the specific role that the state ought to play.

Within the liberal tradition, we can find many different ideologies, which we mentioned by name in the second section:

Neoliberalism, Classical Liberalism, Social Liberalism, Early Capitalism, and so forth are all ideas that have the free market and individuality at the core of their social values.

The idea that combines individual freedom with social justice and the protection of the most vulnerable is **social liberalism**.

Even here, however, representatives of this idea may disagree with one another, and the form of political organization is not determined absolutely by the ideology alone.

Some theorists belonging to this tradition include **John Maynard Keynes, John Stuart Mill, and John Rawls**.

Of these, I would like to examine more closely the views of the latter concerning equality, freedom, and justice, because I believe that he focuses more directly on the problem of inequality and income distribution, which is also the issue I wish to address here and in subsequent chapters of the work.

John Rawls (1921–2002) was one of the most important political philosophers of the twentieth century.

He taught at Harvard University and profoundly influenced modern thinking about justice, equality, and rights.

His most famous theory is presented in his book *A Theory of Justice*, where he introduces three central ideas:

1. **Justice as fairness.**
2. **The veil of ignorance.**
3. **The Difference Principle.**

Through this theory, Rawls made an important contribution to the fields of legal science, political theory, and philosophy, focusing particularly on the question of social justice.

Through these ideas, he addresses the issue of social justice.

It is true that we observe injustice in the world and that, although theoretically we would like to be born and live as equals and possess equal rights, and although this is established by human rights and many constitutional laws, inequality, exploitation, and injustice remain present and, as the years pass, the tendency appears to become increasingly severe.

Rawls himself observed that despite conferences and discussions, little substantive progress was being made on this issue and the situation remained largely unchanged.

Perhaps Rawls should have been discussed separately in the first chapter when we examined the schools of ethics.

Although he is regarded as a continuation of Kant's ideas, we could therefore place him within that category.

Two important successors to Kant were **Robert Nozick and John Rawls**.

The former appears to be a more enthusiastic supporter of the free market and individual rights and freedoms, whereas the latter leaves greater room for state intervention and assigns a specific role to society and the state.

Let us return to the ideas presented in *A Theory of Justice* and then discuss more specifically the type of distribution he proposes.

These ideas concern three separate elements which, when combined, form a whole and shape the type of liberalism proposed by John Rawls for a more just society.

1. Justice as Fairness

In simple terms, this is the idea of **equality of opportunity**.

People are equal not when they occupy the same position, but when they begin from the same starting point.

This concept is connected with the next two ideas, and they are also connected with one another, together forming Rawls's overall ideology.

Equality of opportunity means, for example, universal access to education or healthcare, rather than excluding people or categories of people from these benefits because of low income or other social or political characteristics.

Similarly, barriers to competition and the market should be removed because they impose additional burdens and create a competitive disadvantage for specific groups that does not apply to others.

This occurs when taxes disproportionately burden groups belonging to the same income category or when tariffs and other bureaucratic barriers restrict particular businesses and individuals to a disproportionately greater extent than others.

In such a case, there is no justice, even if there is equality of outcome.

We can understand this better through the next concept.

2. The Veil of Ignorance

The veil of ignorance is an idea through which Rawls attempts to encourage us to think about others rather than exclusively about ourselves.

At the same time, it demonstrates a form of empathy, because he does not ask us to do this selflessly but because we ourselves could find ourselves in the same position.

According to this idea, in order to discover fair rules, we must imagine that we do not know who we will be in society.

Decisions concerning the political and economic organization of society should be made behind a **veil of ignorance**, according to which we do not know the social and economic position of the people who will belong to that society.

We do not know whether we will be rich or poor, healthy or sick, male or female, privileged or a member of a minority.

In this way, we are led to become concerned about the fate of the least advantaged, the unlucky, and the vulnerable, because, hypothetically, any one of us could find ourselves in that position.

The improvement of the position of the weakest members of society is therefore the criterion by which the success of the political and economic system is judged.

3. The Difference Principle

Rawls does not argue that everyone should be absolutely equal.

According to justice as fairness, the principle of equality takes the form of equal opportunities and a game played according to equal rules and freedoms.

There may nevertheless be “winners” and “losers”.

This is acceptable because such inequality contributes to the improvement of society and becomes acceptable under certain conditions: **if it benefits the weakest members of society**.[241]

Therefore, income inequalities and power relationships may exist within society, such as employer-employee relationships, and indeed there may be significant inequalities.

Through these three principles, Rawls presents the ideology which, in his view, could make our world more just.

It is an ambitious attempt to combine the freedom and equality examined in the previous section and to create a society containing elements of both.

The Difference Principle is directly related to the problem of the appropriate distribution of income and wealth within an economy.

Initially, inequality of income exists within society because individuals—starting from the same point and with equal opportunities—move upward through the scale of social mobility.

This inequality is accepted provided that it benefits the least advantaged and therefore society as a whole.

This may be achieved through the dominant form of income distribution within a free society.

In the previous section, when we addressed this issue, we referred to the concept of **trickle-down**.

Trickle-down is directly connected with Rawls's theory of justice, and particularly with his conception of justice as equality and with the Difference Principle that he proposes as one of the fundamental principles of his system.

Trickle-down is a practical application of this principle because it focuses on redistributing resources with the objective of strengthening the vulnerable members of society and ensuring social justice and reducing inequalities.

Example of Application

For example, if an economy is able to generate greater wealth through entrepreneurial or technological innovations, trickle-down could mean adopting policies such as:

- increasing workers' wages;
- improving access to education and healthcare for poorer people;
- implementing social programs that improve the welfare of the least advantaged.

This could be considered consistent with Rawls's principles because it attempts to ensure that inequalities in society—for example, high corporate profitability—ultimately benefit the weakest members of society.

In summary:

Trickle-down and Rawls's theory are related because both focus on the redistribution of wealth or resources with the objective of improving the conditions of the weakest or least advantaged members of society.

Rawls's Difference Principle, which permits social inequalities only when they benefit the weakest, constitutes a fundamental basis for the policy of “trickle-down”.

This is why I wanted to refer to John Rawls.

I believe that the principles he formulated constitute a valuable contribution to the ideology of **social liberalism**.

Social liberalism is a political and philosophical ideology that attempts to combine individual freedom, as in classical liberalism, with social justice and equality of opportunity—which is precisely what Rawls proposes through the principles of the Difference Principle and equality/justice as fairness.

“People must be free—but in order to be truly free, they also need basic social conditions,” is the idea expressed by social liberalism.

As an ideology, therefore, it supports individual rights and individual freedom—for example, freedom of speech and expression, freedom of choice, and protection from arbitrary authority.

It combines this view, however, with equality of opportunity.

If people begin from very different starting points, “equal treatment” is not sufficient.

These equal opportunities are achieved through state intervention and the provision of public goods, such as those already mentioned above: an education system, healthcare, basic infrastructure, a welfare state, and so forth.

We will examine the specific role of the state in the next section.

Before proceeding to the specific role that the state ought to play as guardian and protector of justice and freedom, I would like, following a methodology of Hegelian dialectics, to present some opposing views that can help the reader interpret the idea under examination more accurately and formulate their own personal ideology.

John Rawls is a leading political philosopher of the twentieth century and belongs to the intellectual heritage of Immanuel Kant.

Another successor to the same heritage, but with different positions, was **Robert Nozick**.

Since they share a common element—the Kantian heritage—yet subsequently diverge, it would be useful to examine Nozick's critique.

He says:

> “Instead of trying to prove that your opponent is wrong, try to see in what sense or from what perspective they may be right.”

This view demonstrates how useful such a comparison can be.

Robert Nozick (1938–2002) was an American political philosopher, also a professor at Harvard University, and one of the principal representatives of **libertarianism**.

His most famous work is *Anarchy, State, and Utopia*.

In this work, he presents his libertarian philosophy, which conflicts with that of John Rawls.

This disagreement became a well-known intellectual confrontation of their era.

For example, Nozick believed strongly in individual rights and personal freedom, whereas Rawls emphasized social justice and qualified personal freedom.

Nozick proposed a **minimal state** that would be restricted to what is absolutely necessary: justice, police, and security.

Rawls, by contrast, supported greater state intervention in order to ensure that citizens receive public goods that the profit motive cannot provide because they do not generate profit and therefore private individuals have little incentive to supply them.

Such goods may include healthcare, education, and basic infrastructure.

From this difference arises their respective views on distribution and taxation.

Nozick condemns taxation for redistributive purposes as theft.

“Legal plunder” is a term used by economists such as Murray Rothbard, although the phrase was originally used by the French classical liberal economist **Frédéric Bastiat**.

By contrast, Rawls accepts a significant degree of taxation so that the state can fulfill its role as guarantor of security, freedom, and social justice, with all that this entails, such as income redistribution and the provision of public goods.

It is worth pausing here on Nozick's view of taxation and particularly on the Bastiat-Rothbard phrase “legal plunder”.

Theoretically, it would be useful to have an authority within society possessing the power to do good. However, the power to do good is equally capable of being used to do harm, and no one can guarantee that such power will not be abused by the state, especially given that many different people come and go from positions of power.[242]

Rawls reverses this argument.

If we follow Rawls's line of reasoning, we arrive at the opposite conclusion: by restricting the state's power to do harm, we simultaneously restrict its power to do good.

The state therefore loses the ability to fulfill its role and perform its duties.

What those duties actually are, however, differs according to one's point of view.

For example, inequalities are permissible if they arise freely according to Nozick, whereas for Rawls they are permissible only if they help the weakest and improve their position.

Rawls emphasizes the **just society**, whereas Nozick emphasizes **individual freedom and property**.

If the view concerning human nature described above is correct, then we understand that social liberalism not only fails to prevent injustice and exploitation but may itself become a form of **Social Darwinism**,[243] reinforcing that theory even more strongly than would occur under conditions of freedom.

---

[234] The “Malthusian trap” refers to a phenomenon in which, because of continuous population growth, an economy cannot develop beyond a certain level, since most resources are consumed in meeting the needs of the growing population, thereby limiting development. The term originates from the English economist Thomas Malthus, who, at the beginning of the nineteenth century, argued that population tends to grow geometrically—that is, to double every few years—while productive resources increase only arithmetically, or linearly. According to this view, if population growth exceeds the capacity to produce food and other resources, society will experience poverty, hunger, and limited development.

[235] This support can often be financed through a public-budget deficit, that is, through an increase in public debt. This does not mean that taxation ultimately disappears; rather, the necessary taxation is temporarily postponed until the debt becomes payable in the future or until the date specified in the loan agreement when the amount must be repaid. This

usually occurs through government bonds, although repayment may also take place in installments, as with principal and interest payments on bank loans.

[236] Smith, Adam. *The Wealth of Nations*, 1776.

[237] What gives something utility, however, is the labor added to the original material; otherwise it does not acquire any additional value. For example, a blank sheet of paper has no particular value, but if we draw something on it or write a text, it acquires value, which is precisely attributable to this labor. Adam Smith himself shares this view of value, if we judge from *The Wealth of Nations*. This position is known as the **labor theory of value** and obviously had considerable influence during the eighteenth and nineteenth centuries. Its influence was also connected with Protestant ethics, which regarded labor as blessed by God and elevated every worker, attributing to them a status comparable to that of a priest. This Protestant ethic contributed decisively to the success of Western capitalism. For a reminder of these principles, the reader may consult Chapter 3.1.

[238] Competitiveness means achieving the best possible quality at the lowest possible price.

[239] Maslow's Hierarchy of Needs is a famous model in psychology that describes human needs in the form of a hierarchy. It was developed by Abraham Maslow in 1943. The basic idea is that human beings have different levels of needs and that the more basic needs must be satisfied before higher-level needs can emerge or become important.

The hierarchy is divided into five levels, from the most basic to the highest:

1. **Physiological needs:** food, water, sleep, shelter, breathing, and basic survival. Without these, survival is impossible.
2. **Safety needs:** physical security, financial stability, health, and protection from risks.
3. **Social needs (belonging and love):** friendship, family, relationships, social acceptance, and a sense of belonging.
4. **Esteem needs:** respect from others, recognition, self-esteem, achievement, a sense of worth, and confidence.
5. **Self-actualization needs:** development of one's abilities, creativity, personal growth, and achievement of goals. This is the highest level of the hierarchy and concerns the realization of the individual's full potential.

[240] Smith, Adam. *The Wealth of Nations*, 1776.

[241] Example: If some people receive higher wages because their work benefits the economy, inequality exists. It is nevertheless considered acceptable only if it also improves the lives of poorer people, for example through taxation, social benefits, and so forth.

Another example: doctors who are well paid may be justified if this contributes to a better healthcare system for everyone. By contrast, if the rich become richer and the poor become poorer without any corresponding benefit for them, then this is unjust according to Rawls.

[242] This view derives from Immanuel Kant. In both *Perpetual Peace* and his Essays, we encounter the idea that human beings are inherently imperfect and predisposed toward corruption and passions. We are truly free when our passions do not control us; otherwise, our passions determine our actions, according to the German philosopher.

Therefore, since human beings are naturally imperfect, it follows that a government, since it too consists of human beings, will inevitably be imperfect and subject to the same weaknesses and passions.

For this reason, in the same works, Kant proposes a universal global union of liberal states, without which, he argues, anarchy would be preferable to the establishment of an organized body of political authority based on a social contract.

More specifically, he uses the term “state of savages” rather than “state of nature” in order to contrast his view with that of Jean-Jacques Rousseau.

[243] Social Darwinism is an ideology that attempts to apply ideas from biological evolution to society and argues that social inequalities are “natural,” poverty is the result of “weakness,” and the state should not assist the weak.

CHAPTER 7 — THE STATE, THE MARKET AND THE COMMON GOOD

7.1 The Role of the State

From everything that has been stated so far, both regarding the schools of ethics and the optimal distribution and the idea of society proposed by John Rawls, as well as the ideology of social liberalism, a role for the state clearly emerges.

We have already seen this role more generally on previous occasions; now it would be useful to focus more closely on the specific duties that the state ought to fulfill.

Views concerning the role of the state, together with the relevant ideologies and theories, range from complete statism and the domination of the state over every aspect of life, both in society and in the economy, to the complete freedom of an anarchic society or a liberal economy.

The former finds expression in regimes of so-called **totalitarianism**,[244] while the latter is represented by the political systems that dominate much of the Western world.

I also mention anarchy at this point because even within anarchist ideology the state has a minimal role in terms of its existence.[245]

We will return to anarchist ideology, and more specifically to the so-called **libertarians**, in a later section.

The ideology of social liberalism, as well as many other ideologies ranging from socialism to neoliberalism and from the open to the closed conservative society, represented by political forces extending from the center-left and center-right to clearly right-wing or left-wing parties, as well as centrist parties, occupies this spectrum.

The exceptions are the two extremes of totalitarianism: the authoritarian rule of a dictatorial regime based on nationalist ideology, or a communist regime that imposes complete control over society and individuals.

Nevertheless, it would be useful for the reader to study these two types of regimes as well and examine what positive elements they may contain and how these could be incorporated into the liberal democracies of the West.

Let us not forget, after all, that one of the leading philosophers we examined in the chapter on schools of ethics, **Plato**, was a supporter of ancient Sparta, while both he and **Aristotle** regarded aristocracy as the ideal form of government.[246]

The classical idea concerning the role of the state, encountered in many free-market theorists, from **Adam Smith** to contemporary neoliberal economists, is that the state ought primarily to provide three things:

1. **Internal security**, through a system of justice and policing, so that the agreements individuals voluntarily undertake through contracts are respected.
2. **External security** from foreign threats posed by other civilizations, through a system of national defense.

3. **A system of education**, which, insofar as it benefits society and the economy as a whole, should be collectively funded.

There can be neither a proper democracy nor a functioning free economy if citizens do not possess basic skills such as arithmetic, reading, and so forth.

For this reason, education should be public, at least at the primary levels. With regard to secondary and higher education, the argument for complete state ownership appears less compelling.

This view is expressed, for example, by Nobel Prize-winning economist **Milton Friedman** in his work *Capitalism and Freedom*.

Adam Smith, in *The Wealth of Nations*, also refers to certain basic infrastructures that serve trade and society and which therefore fall within the responsibilities of a state that ought to provide them, such as bridges, roads, ports, canals, and so forth.[247]

There are many arguments supporting this reduced role of the state.

One of them is that people have a greater interest in protecting property when it belongs to a private individual who regards it as their own and therefore has a greater incentive to protect it.

By contrast, when property belongs to the state—which theoretically represents society as a whole—individuals may perceive it as something foreign to them, from which they receive no substantial personal benefit.

Another very important argument is that the concentration of power required by the state to fulfill its duties constitutes a threat to individual freedom.

The power to do good is simultaneously the power to do harm, and nobody can guarantee the ideal or perfect and just character of those who govern, especially within a system in which the individuals occupying positions of power change over time.

Furthermore, society and taxpayers may feel relieved when the state transfers some of its responsibilities to private individuals, provided that the profit motive is sufficient to ensure equally effective service to society and to prevent fraud or profiteering.

As we have seen in previous chapters—particularly Chapters 3 and 4, and to a lesser extent Chapter 2—the protection of the interests of each party against possible fraud requires knowledge and access to complete information.

For this reason, information must be publicly accessible and no party should possess substantially more information than another; otherwise, a **moral hazard** arises.

The state should therefore require businesses to disclose their financial information, maintain accounting records, and publish basic financial statements, particularly in the case of publicly listed companies that raise capital from the public through financial markets.

In addition, businesses and governments are evaluated by credit-rating agencies in order to determine accurately their ability to repay debt and meet their financial obligations.

Such requirements provide a framework for government intervention because they complement a free market and ensure that the profit motive is not accompanied by moral hazard.

These are some of the most important arguments that can be found among theorists of free-market capitalism. They are not, however, the only ones, and there would be little purpose in providing a completely exhaustive account within the framework of this work.

For all these reasons, free-market economies consider an economy and society to function more effectively when businesses and property belong to private individuals rather than to the state and are therefore organized in this way.

In practice, of course, economies are mixed, and there are businesses that belong partly to the state and partly to private individuals, both separately and within the same company.

For example, extensive public-sector activity and government intervention, through the provision of public goods and taxation, can be found even in free-market economies such as the United States, Canada, Australia, Germany, Sweden, and others.

On the other hand, in centrally controlled economies such as China, Venezuela, and Russia—although to a lesser extent—we also find multinational corporations, private individuals, and stock exchanges through which their shares are traded.

Ownership can therefore pass into the control of private interests and does not necessarily belong exclusively to the state.

For all the reasons mentioned above, as well as others that we have not analyzed here but have discussed in previous sections—such as the problem of unintended consequences and externalities—even within a liberal economy based on the free market there must be certain basic public and common goods.

We will address this issue in the next section, where we will also examine stronger arguments originating from socialist or center-left traditions, but often also from right-wing or liberal political groups, concerning the role of the state.

These positions accept many of the arguments presented above but, with some additional considerations, assign a broader role to the state.

After examining these cases, we will then attempt to find the **golden mean between the state and the market**.

7.2 Public Goods, Common Goods and Collective Action

What distinguishes a free market from a centrally planned economy is the extent of the public and common goods available within an economy, as well as the role of collective action.

It is therefore important to define these concepts so that the reader understands what we mean.

1. Public Goods

Public goods are goods that are accessible to everyone and therefore do not possess the element of **excludability** and do not create competition over their use.

For this reason, such goods can be produced and supplied by the state.

Examples include national defense, lighthouses for ships, clean air, and so forth.

2. Common Goods

Common goods possess the element of non-excludability mentioned above, meaning that it is not easy to exclude someone from using them.

However, unlike public goods, there is competition over their use because their quantity is limited.

Examples include fish in the sea, grazing land, forests, water reserves, a bench, a bus stop, and so forth.

Public and common goods are produced and supplied by the state in a centrally planned economy, [248] because in this way the state has the ability to decide who will bear the cost of providing these goods and who will receive their benefits.

In this way, wealth can also be redistributed from higher incomes, which are taxed at higher rates, toward lower incomes, whose recipients benefit from public goods.

Of course, a prerequisite is that the state must tax genuine wealth rather than lower incomes and that the actual beneficiaries of state assistance must be the economically weaker groups rather than the strongest economic classes.

In the next chapter we will examine how this can be achieved through the tax system and the types of taxation that can be used to distribute more fairly the burden of financing public goods.

Redistribution, however, is not the only argument in favor of expanding public goods.

Public goods are provided by the state, and the state represents society. Therefore, every expansion of public goods improves the level of society and ensures that the provision of goods does not become concentrated in a small elite.

The state is capable of providing full employment to its citizens, stimulating aggregate demand when the economy is weak, and applying the principle of equality, since when a good is public, everyone has access to it.

With regard to this role of the state in stimulating effective demand, I recommend that the reader consult the work of the British economist **John Maynard Keynes (1883–1946)**.

During the historical period of the **Great Depression in the United States**, following the stock-market crash of 1929 and the collapse of the banks, there was a major decline in effective demand because citizens' incomes had fallen.

There would be little point in explaining the causes and the phenomenon of the Great Depression through a complete analysis here.

However, it can be said that what helped the United States escape the deadlock was President Roosevelt's **New Deal**, which consisted of a series of government measures intended to support incomes and employment.

Of course, many argue that even these measures were insufficient and that the economic crisis was only definitively overcome after the beginning of the Second World War.

War, however, is nothing other than a public good.

Regardless of how we judge this issue, public goods can contribute to improving incomes and employment.

Moreover, when society as a whole controls the means of production and industries, manufacturing enterprises, banks, and so forth, it is more difficult for these institutions to collapse than when they belong to an individual or a small group of owners.

The economy is therefore more stable and less vulnerable to the major cycles of expansion and contraction to which a completely free market, guided exclusively by the profit motive, is vulnerable.

Finally, there is an argument in favor of public goods that can be justified even from the perspective of a free market and an individualistic ethic.

I am referring to the well-known **free-rider problem**: some individuals benefit without paying.

For this reason, public goods are often provided by the state or financed through taxation, thereby ensuring that everyone pays the share corresponding to them.

Otherwise, an individual may enjoy the provision of a good that someone else has paid for, exploiting the fact that no one can easily be excluded from receiving that good.

Such a situation constitutes clear exploitation, particularly when providing the good requires a large amount of labor, effort, capital, and so forth, which cannot be secured if such free-rider behavior becomes widespread.

This problem resembles the problem of unintended consequences discussed in an earlier section and creates room for state intervention, which may be necessary to protect individuals from the violation of their individual rights and freedoms by other individuals.

Furthermore, the profit motive cannot guarantee certain essential needs of society because these needs do not generate sufficient profit.

Consequently, under a completely free-market system, no one may undertake the provision of goods that are essential for satisfying these needs.

Such cases may concern goods that satisfy people's needs for education, learning, the use of reason, or an effective healthcare system, which could be underprovided without state support.

Under a completely free market, individuals may be concerned primarily with their own interests, and therefore society's need for healthcare, education, and similar services may be neglected to a greater extent.

In practice, television personalities, famous football and basketball players, singers, and others are often paid much more than those who provide healthcare or food, even though access to food constitutes one of the major problems facing the planet.

In such cases, state intervention and the provision of public goods that satisfy these higher intellectual or generally human needs may be necessary.

The argument here is that not all human needs are equally important.

Since human needs are, first, unlimited and, second, not subject to definitive saturation, and given the economic problem of the scarcity of factors of production, some needs must necessarily be sacrificed while others are satisfied.

The purpose of a rational human being is to calculate the costs and benefits of each choice and make a rational decision that satisfies their most important needs.

The objective should not be so much the maximization of pleasure as the reduction of pain or, if one prefers, it should not focus exclusively on pleasure or enjoyment.

Regarding the importance of needs, it is worth saying first that not all needs are genuinely necessary for our survival.

They can be divided into two important categories:

1. **Survival needs (needs).**
2. **Social, cultural needs or desires (wants).**

The first category concerns basic biological needs such as food, water, clothing, and so forth, as well as human needs for security: shelter, ensuring that biological needs can be satisfied in the future, financial security, appropriate living conditions such as heating, and so forth.

The second category concerns needs that developed later and involve the desire to follow patterns of consumption accepted by society, such as using modern mobile phones and cars, or wanting a larger home.

One criterion for distinguishing between them is to consider what needs primitive humans had compared with those of modern humans.

Another important tool that can help us determine the importance of needs is **Maslow's hierarchy of needs**.

Within this hierarchy, survival needs would correspond to the first two levels of needs, while social needs would correspond to the remaining levels.[249]

The final two arguments—the free-rider problem and the insufficient supply of goods necessary to satisfy higher or more essential needs through the profit motive—are arguments that are often accepted even by economists, political scientists, and philosophers who are sympathetic to economic freedom.

These groups do not always agree with one another, however.

For some so-called **libertarians**, every form of state intervention is unacceptable, whereas for more socially liberal or neoliberal thinkers, the intervention described above is necessary not to protect society or the public interest, but the individual himself.

As for common goods, here the free market may protect these goods from misuse and overexploitation.

As mentioned earlier, a common good cannot easily exclude users, but it creates competition for its use.

Therefore, an exclusion mechanism must be found.

Otherwise, competition combined with non-exclusivity will lead to overexploitation and destruction of the common good.

The free market, through the **price mechanism**, provides such an exclusion mechanism without the need for a state authority.

7.3 The Golden Mean Between the State and the Market

From everything that has preceded in this chapter, we can conclude that public goods are necessary even in a **laissez-faire** economy, just as economic freedom is necessary in centrally planned economies.

The precise justification for expanding public goods was presented in the previous section, and from the arguments and cases discussed, the reader can understand how government intervention and public goods can be beneficial even for the protection of individuals and individual rights.

We therefore arrive at the solution of **mixed economies**, a position that is no longer seriously disputed after the painful experience of the destructive recessions and inflationary tendencies experienced by humanity, beginning with the historical period of the Great Depression of 1929.

Before the onset of the catastrophic recession, liberal economists such as Adam Smith dominated economic thought and advocated economic liberalization and fewer regulations.

An intervention by the state to address problems of inflation or reduced employment—assuming that this was the problem—would have had the consequence of worsening the situation because the private sector itself and the price mechanism tend to move spontaneously toward equilibrium.

Therefore, additional external intervention by the state through taxation and expenditure could worsen inflation or prevent the changes necessary for an economy to become competitive and address possible balance-of-payments problems.

However, when the great stock-market crash of 1929 occurred on the New York Stock Exchange, prices fell and those who had invested their money suffered losses.

Such a market decline clearly causes a redistribution of income from the many who did not adequately understand the risks they were undertaking toward the so-called **“smart money,”** which enters the market at the early stages of a new trend and comes from institutional investors or large financial institutions.

Even more important, however, is the psychological effect produced by such news.

It can result in a run on banks and a wave of massive capital withdrawals, which can create a genuine liquidity problem for banks.

Thus, the crisis moved from the stock market to the banks and became an actual banking collapse and recession in the real economy.

At this point, the economy encountered a problem it had not previously faced: insufficient **effective demand**.

That is, although products were available, there was insufficient income to keep the economic circuit functioning.

The measures that were taken, including reductions in wages and so forth, further aggravated this deficiency in demand.

At this point, the ideas of bourgeois economists such as Adam Smith began to recede and gave way to new ideas, such as those of the British economist **John Maynard Keynes**, which became highly influential.

Through his work *The General Theory of Employment, Interest and Money*, as well as through his broader economic theory and teaching, Keynes promoted the idea that the state has a more active role to play and should intervene to restore demand when the private sector is no longer capable of generating it.

Thus, we moved from the model of a completely free economy toward the model of **mixed economies**.[250]

Having experienced the negative consequences of a completely free market, as well as examples of the collapse of centrally planned economies, such as the Soviet Union later in the same century, we can safely exclude the two extremes:

- a completely free market without any government intervention and without a public sector;
- and an absolutely centrally planned economy that concentrates all power in the hands of the state and suppresses all economic freedom.

However, in order to find the **golden mean between the state and the market**, it would be worthwhile to examine the two extreme models described above and, following a dialectical method, allow the reader to draw their own conclusions.

After this analysis, I would like to present my own position on the subject and design a political economy as I believe it ought to be and as we need.

At one extreme, therefore, are the economic and political ideologies associated with the completely free market: **Classical Liberalism, Neoliberalism, Anarcho-Capitalism**, and so forth.

The anarchist ideology also includes the so-called **libertarians**, who reject every form of government intervention in the economy, including interventions that might perhaps be justified by classical and neoliberal ideas.

According to the political economy of freedom, the state should withdraw from all economic activity and allow individuals and private entities to control the economy.

This position is supported by many arguments, many of which we have already discussed in previous sections:

1. Separation of Economic Power from Political Power

This ensures that there is no concentration of power and that administration is based on a decentralized model.

The power to do good is simultaneously the power to do harm, and such a concentration of authority would constitute a threat to freedom.

Therefore, by removing the state from the economy, freedom is protected.

2. Greater Interest in Protecting Property

When property belongs to the state, which theoretically represents society as a whole, individuals may perceive it as something foreign that does not belong to them, since the individual benefit they receive from it is negligible.

3. Better Service to the Citizen-Customer

The profit motive, combined with a competitive market, protects the interests of everyone.

Consumers can choose not to buy from private individuals whom they consider greedy, dishonest, or poor at their work—for example, uncompetitive businesses.

Employees can find an employer who offers better remuneration if they believe another employer undervalues their labor.

Finally, an entrepreneur can protect themselves from the demands of a customer through the existence of other customers with whom they can cooperate.

In a similar way, the interests of all groups within the broader environment of the business, such as suppliers, are served.

This ensures that the interests of citizens are satisfied regardless of the position they occupy—consumer, employee, entrepreneur, and so forth.

4. Economic Efficiency

A private business, as well as a decentralized public organization, is able to understand local market conditions and respond more effectively by taking into account the needs of both consumers and workers.

Furthermore, the profit motive is much stronger than the motivation of simple selfless duty.

5. Addressing the Fundamental Economic Problem

In Chapter 2 we referred to this problem.

The fundamental economic problem arises from the number and nature of human needs and the finite productive resources available in nature.

This limitation means that not all needs can be satisfied, and a choice must therefore be made between the needs that will be satisfied and those that will be ignored.

Economic science, through the tools it provides, helps us make a rational choice.

The price mechanism, available income, and the basic economic principle of cost-benefit analysis provide a way of addressing the problem of scarcity.

By contrast, in an economy with an extensive public sector, this problem may be ignored, without this meaning that it ceases to exist or ceases to be a fact of life.

6. Fair Valuation of Value

This argument can be invoked both by supporters of a free economy and by supporters of a centrally planned one, although not in exactly the same way.

For the former, only free negotiation in the market can provide a fair valuation of value.

For the latter, public opinion may often be misled into making incorrect decisions because it lacks sufficient knowledge or information or is susceptible to manipulation, greed,[251] and so forth.

7. Relief of the State Budget

When the state transfers some of its responsibilities to private individuals, the state—and the society it supposedly represents—is relieved of part of its burden.

This can reduce the burden of public debt and excessive taxation.

8. Strengthening Society

Society is the totality of voluntary actions undertaken by individuals, rather than the state that supposedly represents it.

Bureaucrats and politicians do not genuinely care about the public interest but about their own personal interests.

Supporters of centrally planned economies reverse this argument and maintain that a larger and freer market means a smaller state and therefore a contraction of society itself.

9. The Absence of a Clear Definition of the Public Interest

There is no clear and objective definition of what constitutes the public interest.

By contrast, individual interest is clear and easily understood.

10. Addressing Inflation

According to various economic studies and research, a free economy tends to exhibit lower inflation rates than economies characterized by a strong state presence.

These are, broadly speaking, some of the strongest arguments in favor of **laissez-faire capitalism**.

This analysis, however, can be misleading if we do not also examine a criticism of it.

The critical or negative side of a free market can be understood indirectly by presenting the positive characteristics of a centrally planned economy.

Examples of centrally planned economies can be found in ideologies associated with communism and socialism, while some characteristics may perhaps also be found in right-wing fascist regimes based on tradition and the nation.

Advantages of a Centrally Planned Economy

1. **Cohesion and Stability.**
   A centrally planned economy can more easily be directed toward the objectives chosen by a

central authority than a completely free economy that depends upon the decisions and actions of thousands of individual economic centers and individuals.

2. **Absence of Political Cost.**
   In the case of totalitarian regimes that do not possess a democratic system, governments or rulers can make rapid decisions without losing time in voting and without having to consider the interests of groups that would create political costs in a democracy.

   Examples include the interests of large business groups, shipowners, media owners, and even ordinary voters, whether corrupt or not.

   The authority may often have good intentions and attempt to address a problem, but individual interests may diverge.

   This argument does not apply to socialist economies with democratic political systems.

3. **Equality or Reduction of Inequalities.**
   Inequality is a side effect of the profit motive.

   A centrally planned economy, however, does not operate primarily on the basis of profit and therefore does not generate the same side effect of increasing inequality.

   Furthermore, the state can address inequality through taxation, whereas a completely free market lacks this mechanism and relies on other, less effective mechanisms, such as correcting market imperfections and ensuring perfect competition, which are often impossible under particular conditions.

   We will discuss taxation in greater detail in the next chapter.

4. **The Public Interest Has Genuine Priority over Narrow Individual Interest.**
   In a free market, the means of production and property generally belong to private individuals.

   Private individuals, however, are concerned primarily with their personal interests and not with the public interest, whatever that may be.

   They are not even necessarily concerned with achieving equilibrium in the market.

5. **Protection of Society.**
   Earlier we saw that, for supporters of the free market, expansion of the state reduces the power of society.

   For supporters of a centrally planned economy, however, such expansion protects society's interests.

   Private decisions are made exclusively with the objective of maximizing profit, while other consequences, whether positive or negative, may be ignored.

   In an economy with a strong state presence and an extensive public sector, however, society may be protected with regard to the environment, nature, human rights, and so forth.

For example, industries may be required to comply with environmental protection regulations when they are private, while public industries simply comply with the law and do not necessarily face the same profit-related incentives to violate it.

On the roads, we may see more public transportation and fewer cars that cause traffic congestion, noise pollution, and environmental damage.

In schools and universities, knowledge rather than wealth is rewarded.

6. **Fair Valuation of Value.**
   The argument presented above in relation to the free market applies here as well.

   The market does not necessarily lead to a fair valuation of value but to a valuation that simply benefits the party negotiating.

   In this way, quality in general is also strengthened.[252]

7. **Guaranteeing Full Employment and Human Rights.**
   The state has a responsibility to ensure full employment and combat unemployment.

   A private economy, by contrast, will employ people only when doing so benefits the private employer.

   Through legislation and its power to intervene, the state can also protect the rights of people who might not be protected within a free market.

   For example, it may legally require the employment of vulnerable groups or immigrants in private businesses or public services.

   The same can apply to other groups that are disadvantaged in some way.

   For example, large families, persons with disabilities, and others may receive priority in state support, whereas private businesses may focus primarily on groups capable of generating profit.

8. **Protection from Exploitation.**
   In a private market, exploitation may exist because each side is concerned with its own interests and the balance between these interests is fragile, depending on external factors that may also be random.

   The state takes responsibility for labor rights, consumer protection, citizen protection, and, importantly, the protection of borrowers who face banks that may threaten individual property.

   Strengthening banks is also a force that can threaten freedom, just as strengthening the state can.

   This argument could also be incorporated, in a broader sense, into point number 5.

These are some basic arguments in favor of a centrally planned economy.

The list is certainly not exhaustive, and the reader may think of additional arguments both in favor of the free market and in favor of a centrally planned economy.

Having presented these positions concerning the two extreme types of economy, I would now like to state my own position.

Having accepted the value of mixed economies, I believe that an economy and a society should establish clear limits on free competition.

The free market and competition are necessary elements because they are compatible with human nature, and only through them can we realistically achieve progress and prosperity.

A centrally planned economy, such as communism or socialism, may appear attractive in theory but may fail in practice because it ignores the fundamental assumptions accepted by liberalism: namely, that human beings are self-interested and act as **Homo Economicus**, rather than **Homo Politicus**. [253]

There must therefore be limits to competition.

There should be a **lower threshold**, below which the individual is protected by the state through the provision of housing, electricity, water, and so forth, free of charge through public expenditure or without cost by state decision for reasons of public interest.

There should also be an **upper threshold**, above which an individual should not be able to accumulate and expand their income and wealth indefinitely.

For example, primary residences should be protected and there should be an upper limit on real-estate ownership, such as a limit of five or ten properties.

Corresponding limits should exist on people's incomes, and there should be no “loopholes” allowing certain individuals to escape these measures.[254]

Finally, there should be an **intermediate level**, in which the rules of laissez-faire capitalism and the free market apply.

Competition benefits society and gives people the incentives they need for development and progress.

It would be a mistake for public assistance to cover every citizen.

It should be limited to the vulnerable.

If such assistance applied to every income category without exception, this would essentially mean that poorer people participate in financing the expenses of wealthier groups.

Furthermore, if a service is public—for example, a hospital—and offers free healthcare services to citizens, an inevitable “shortage” or inability to serve all citizens may arise.

We can understand this more clearly through the supply-and-demand diagram and the equilibrium point, concepts examined in Chapter 2.

If we assume that the service is public and provides services free of charge, this is equivalent to setting the price **P = 0**, that is, at the lowest point on the vertical price axis.

At this point, not only does a shortage exist, but the shortage is maximized, and the more elastic demand is, the greater the problem becomes.

If the demand curve for a good is inelastic, the problem is less significant, and in cases of perfectly inelastic demand,[255] this problem would not arise.

Such a problem often appears in monopolistic companies.

In such cases, the state could assume ownership of monopoly companies, particularly when the good concerned is considered especially important from a social perspective.

It is the responsibility of the state to ensure that everyone is able to satisfy their basic survival needs, either independently or with the assistance of the state.

form of **Social Darwinism**,[243] reinforcing that theory even more strongly than would occur under conditions of freedom.

---

[244] The term and analysis of totalitarianism were developed mainly during the twentieth century by political thinkers, including **Hannah Arendt** in her work *The Origins of Totalitarianism* (1951). **Giovanni Gentile**, an Italian philosopher, contributed ideologically to fascism and to the use of the term in Italy, while **Benito Mussolini** was the first to use the expression "totalitarian state" (*stato totalitario*) to describe the fascist regime. Totalitarianism is a form of political regime in which the state seeks to exercise complete control not only over political life but also over the social, economic, and even private lives of citizens. In a totalitarian system there is usually a single dominant party, a powerful ideology that penetrates all aspects of life, control over information and propaganda, suppression of opposition, and restriction of freedoms. Such regimes often feature a charismatic or authoritarian leader. Classic examples discussed in theory include Nazi Germany under **Adolf Hitler** and the Soviet Union under **Joseph Stalin**.

[245] See Chapter 6.3 concerning **Robert Nozick** and his work *Anarchy, State, and Utopia*.

[246] Specifically, in *Politics*, Aristotle presents his own classification of political constitutions and places **kingship** first, in which the king constitutes an earthly representation of Zeus (the god)—something that appears to resemble a political system of government approaching theocratic rule.

[247] His basic idea is that such infrastructure is necessary for economic development and trade but is often not profitable for private investors, or does not generate immediate profit. Therefore, the state should undertake or finance it. However, where possible, he prefers some form of cost recovery—for example, tolls—so that taxpayers do not bear the entire burden and better management can be achieved.

[248] In a centrally planned economy, the means of production belong to the state or are regulated and managed by the government and the public sector. There are committees that plan and decide what will be produced in an economy, how it will be produced, by whom, and so forth. These bodies therefore manage the subject matter of political economy.

[249] See page 151.

[250] It should be noted that both the left and the right accepted the idea of a completely free economy at an earlier stage, whereas after the experience of 1929 these ideas gained primarily greater acceptance on the left, without nevertheless leaving certain groups within the broader right-wing political sphere completely indifferent.

[251] Greed constitutes one cause of an incorrect valuation of value. It is a bargaining strategy through which someone seeks to acquire a highly valuable good at a low price and thereby maximize personal profit.

[252] See the problem of **"bad lemons."**

[253] The term **Homo Politicus** literally means "political man" and is used to describe human beings as beings who live and act within a political community. The idea is associated with Aristotle, who stated that human beings are *"zoon politikon"*—that is, by nature social and political beings. This means that people organize themselves into societies, care about the common good and governance, possess political consciousness, and participate actively—for example, by voting or expressing opinions—and are both influenced by and influence political life.

In simple terms, it is the human being as an active citizen, rather than merely as a private individual.

As a concept, it is the opposite of *Homo Economicus*. The model therefore concerns an altruistic human being who cares about the public and social interest, places others above himself, and may demonstrate self-sacrifice by giving up personal benefit for the sake of the collective.

As a behavioral model, it may be found in political science, sociology, psychology, and related fields.

Even within economics, this assumption is effectively made when we suppose that politicians and economists follow normative ideas without seeking some other personal benefit.

Conversely, the term *Homo Economicus* can also be used in political science, sociology, psychology, and other disciplines to understand and manage political issues.

This approach has been developed in particular by economists belonging to the **Public Choice School**, who also belong to the broader tradition of classical liberalism.

James Buchanan, a characteristic representative of this school, considered himself philosophically close to anarchy, at least at the theoretical level.

The critique mentioned above—that economists often formulate normative theories that appear to adopt the methodology of Rousseau or Kant rather than the model of *Homo Economicus* and the basic economic principle—also derives from this perspective.

[254] Studies show that as income increases, life satisfaction also increases, primarily because basic needs such as housing, health, and security are satisfied. However, this increase does not continue indefinitely.

Contemporary research suggests that the relationship has an **inverted-U shape**, meaning that beyond a certain point additional money does not significantly increase happiness.

A major international study identified “income-satiation points” beyond which well-being stabilizes.

Other studies estimate that emotional well-being may reach a level of approximately **$200,000 per year**, although this depends on the country and living conditions.

Other studies place the threshold at approximately **$70,000**, although this may appear to be a relatively low threshold.

[255] The percentage change in the quantity demanded divided by the percentage change in price is called the **price elasticity of demand**. We can therefore understand price elasticity of demand as the degree of responsiveness or reaction of consumers to changes in price, with all other factors held constant (*ceteris paribus*).

[256] Theodoros Lianos, Antonios Papavasileiou, Andreas Chatzianandreu, *Principles of Economic Theory*, Third Grade of General Lyceum: Elective Course, “Diophantos” Publications, 2000.

CHAPTER 8 — TAXATION AND MORAL LEGITIMACY

8.1 Why Do We Pay Taxes? The Historical and Philosophical Foundation

In this chapter, we will discuss taxation, which concerns the administrative and fiscal methods through which the government collects revenue. This revenue is necessary for the state to fulfill its duties and therefore constitutes part of its obligations arising from the **social contract**.[257] However, taxation also existed in antiquity.

Historically, this need emerged very early, from the time when human beings began to form organized societies with a specific structure and hierarchy: Ancient Egypt, Mesopotamia, and so forth, approximately 5,000 years ago.

In these societies, taxes were paid in kind or in money, which could take the form of a commodity such as wheat or animals, or could take the form of labor or military service.[258]

In this way, the creation and maintenance of armies, temples, universities, markets, and all the buildings we see in the ancient city-states and later empires during the Middle Ages were made possible:[259] walls, castles, prisons, such as the Bastille, or palaces.

Therefore, taxation was initially a means of collecting revenue that made the existence of collective organization possible.

During the Middle Ages, taxes were regarded as a special privilege of the monarch, whose authority derived from the belief that he was God's chosen representative on Earth.

From this authority derived his jurisdiction to impose taxes.

Gradually, however, the situation changed. What had once been regarded as a legitimate privilege of the king began to be considered an unreasonable demand and led to a series of struggles, uprisings, and revolutions aimed at overthrowing these regimes.

A critical point was the **Magna Carta**, which established the principle that the king could not impose taxes arbitrarily without consent.

Historically, this was followed by the revolutions we have already mentioned:

1. The **Glorious Revolution** in England in 1688;
2. The **American Revolution** for independence in 1776; and
3. The **French Revolution** in 1789.

The slogan that prevailed was:

“No taxation without representation.”

This meant that taxation should not be imposed without political representation and, particularly during the American Revolution, became a central demand of the British colonists who rebelled.

During the nineteenth and twentieth centuries, taxation was transformed from a means of maintaining political authority into a means of achieving the redistribution of wealth, establishing the welfare state, and protecting people's rights.

Taxation itself did not disappear. It simply ceased to be regarded as an instrument of the sovereign power of the monarch—or of the God from whom his authority supposedly derived—and became an instrument of the sovereignty of the people.

Here the idea of the **social contract**, which we mentioned at the beginning, emerges.

The theory of the social contract is associated with philosophers such as **Thomas Hobbes, John Locke, and Jean-Jacques Rousseau**.

The basic idea is:

- without a state, insecurity prevails;
- people surrender part of their freedom and wealth;
- in order to secure:
    - security,
    - justice,
    - stability,
    - and common goods.

Therefore, taxation is regarded as participation in the cost of collective life.

A number of schools of thought and ideologies subsequently developed philosophical approaches intended to legitimize taxation in the modern state based on popular sovereignty, beyond the idea of the social contract and the philosophers associated with it.

One philosophical approach is the **school of Utilitarianism**, associated with **Jeremy Bentham** and **John Stuart Mill**.

According to this school, taxation is justified when it maximizes the benefit of society and minimizes suffering; that is, when it maximizes welfare, combats misery, and contributes to the provision of goods that benefit everyone, such as roads, schools, hospitals, and so forth.

Another approach is the **liberal or individualistic approach**, associated with philosophers connected with the free market, and more specifically with the so-called **libertarians** and **Robert Nozick**.

Nozick argued that excessive taxation violates individual property rights, that the state should be limited, and that citizens should not be treated as “means” for social purposes.

The arguments encountered here can also be found in other ideologies within the free-market spectrum, such as **Neoliberalism, Classical Liberalism, Social Liberalism**, and others.

Another philosophical approach is that of **social justice**.

We could associate it with **John Rawls**, who argued that inequalities are justified only when they benefit the least fortunate or least advantaged.

Therefore, progressive taxation is morally justified insofar as it contributes to this objective: equal opportunities, reduction of inequalities, and social cohesion.

The basic principles that a tax system ought to follow are:

1. Reciprocity

There should be a genuine service or protection that we enjoy in return for the payment of taxes.

2. Collective Action

Certain goods cannot be provided individually because their exploitation does not generate sufficient profit.

In such cases, a mechanism for collecting financial resources is necessary in order to provide these goods.

This mechanism is **taxation**.

3. Redistribution and Justice

The reduction of income inequality.

4. Legitimization of the State

Taxation is connected with participation and political rights.

Different philosophical ideas and approaches assign different importance or weight to the values described above.

For example, reciprocity may be associated more closely with a liberal approach, collective action with the idea of social justice, redistribution with the social liberalism of **John Rawls**, and finally the legitimization of the state with more conservative political regimes and ideologies.

To conclude this section, it is worth mentioning that although the complete rejection of taxation has theoretically been supported by some economists, taxes have historically always existed.

After all, the familiar expression is:

“Two things are certain in life: death and taxes.”

What has been the subject of historical controversy is not so much whether taxes should exist, but **who should pay, how much should be paid, and how the state should manage this money**.

These concerns led to different ideas and ideologies that emerged as a natural consequence of applying these ideas: liberals, social democrats, socialists, libertarians, conservatives, anarchists, and so forth.

8.2 Progressivity, Fairness, and Tax Ethics

In order to assess whether a tax system is fair, it is not enough to know that the state needs revenue. We must examine how this revenue is collected and how the tax burden is distributed among citizens. The state makes public expenditures to provide goods and services such as education, healthcare, defense, public administration and infrastructure. At the same time, it makes transfer payments, such as pensions, benefits and other forms of social assistance. These two categories are not the same. When the state constructs a road or pays employees to provide a public service, it is making expenditure on a good or service. By contrast, when it pays a pension or benefit, this constitutes a transfer of income to the recipient.

To finance these activities, the state uses various sources of revenue. The most important is taxation, while other sources include fees, state-owned assets, business activity and borrowing. Government borrowing can be used to finance expenditures today, but it creates future obligations. Loans must be repaid and are usually accompanied by interest. For this reason, borrowing cannot be considered a permanent substitute for taxation.

Tax Base and Tax Rate

In order to understand how a tax operates, we must first distinguish between two basic concepts.

The tax base is the economic magnitude on which a tax is calculated. It may be income, the value of a property, consumption or another economic measure.

The tax rate is the percentage applied to the tax base.

For example, if the tax base is €2,500 and the tax rate is 12%, then:

2,500 × 12% = €300 tax.

If the tax base increases to €8,000, with the same tax rate:

8,000 × 12% = €960.

The relationship is therefore:

Tax = Tax Base × Tax Rate

Direct and Indirect Taxes

Another important distinction concerns direct and indirect taxes.

Direct taxes are imposed directly on an economic measure relating to the taxpayer, such as income or property.

Indirect taxes are mainly associated with consumption and transactions. A typical example is VAT. In this case, the tax is collected during the transaction and ultimately borne by the consumer.

This distinction is connected with the issue of tax shifting. A tax may initially be imposed on one economic agent, but part or all of its burden may ultimately be transferred to someone else.

Proportional and Progressive Taxes

A proportional tax uses the same tax rate regardless of the size of the tax base.

Suppose there are three incomes:

A = €120,000

B = €350,000

C = €2,400,000

With a proportional tax rate of 15%, the tax would be:

A: 120,000 × 15% = €18,000

B: 350,000 × 15% = €52,500

C: 2,400,000 × 15% = €360,000

The tax rate remains the same, so the tax burden as a percentage of income is 15% for everyone.

A progressive tax, by contrast, uses higher tax rates for higher levels of the tax base.

Let us assume the following hypothetical tax scale:

Income bracket	Tax rate
€0 – €300,000	8%
€300,001 – €800,000	18%
€800,001 – €1,500,000	32%
Above €1,500,000	50%

Here it is important to understand that under a progressive, bracket-based tax, each tax rate applies only to the portion of income that falls within the corresponding bracket.

For example, for an income of €1,800,000:

First €300,000 × 8% = €24,000

Next €500,000 × 18% = €90,000

Next €700,000 × 32% = €224,000

Last €300,000 × 50% = €150,000

Total tax: €24,000 + €90,000 + €224,000 + €150,000 = €488,000

The average tax rate is:

488,000 / 1,800,000 ≈ 27.1% [260]

This demonstrates an important difference between the marginal tax rate and the average tax rate. The 50% rate in the final bracket does not mean that the taxpayer pays 50% of their entire income. The 50% rate applies only to the portion exceeding the relevant threshold.

The Main Categories of Taxation

Depending on the economic measure that constitutes the tax base, we can distinguish three broad categories:

income taxes,

property taxes,

consumption or expenditure taxes.

Income tax is directly related to the taxpayer's economic capacity. For this reason, it can more easily be used as a tool of progressive taxation.

Property taxes are based on the value of assets such as real estate. Their advantage is that property is generally easier to identify than income that may be concealed. On the other hand, owning property does not always mean that the owner has a correspondingly high current income. A person may own a highly valuable property while having limited disposable income. However, property taxes are vulnerable to the business cycle, which constitutes one of their disadvantages. Tax evasion may nevertheless be more difficult in this case, although property taxation is not necessarily as fair as income taxation. [261]

Consumption taxes, such as VAT, have a different character. They are relatively easy to collect because they are incorporated into transactions, but they create an important issue of fairness: lower-income households generally consume a larger proportion of their income.

Let us consider a different example.

Suppose there are two individuals:

Person A: income €1,500, consumption €1,200

Person B: income €6,000, consumption €2,400

With a hypothetical VAT rate of 15%:

For A:

1,200 × 15% = €180

The €180 corresponds to:

180 / 1,500 = 12% of their income.

For B:

2,400 × 15% = €360

The €360 corresponds to:

360 / 6,000 = 6% of their income.

Although the second person pays a larger amount of tax in absolute terms, the tax burden as a percentage of their income is lower.

This is one of the main arguments made by those who believe that excessive reliance on consumption taxes can create a regressive effect. On the other hand, income taxes present their own problem: income can be concealed or shifted in ways that make tax enforcement more difficult. Therefore, a theoretically fairer tax is not necessarily the easiest tax to administer in practice.

The Dilemma of Progressive Taxation

Progressive taxation creates a classic dilemma between fairness and economic incentives.

On the one hand, it can be argued that a person with greater economic capacity can contribute a larger percentage of their income without a corresponding reduction in their ability to meet their basic needs. In addition, the additional revenue can be used to finance social policies.

On the other hand, a very high tax rate on high incomes may affect incentives for work, investment, entrepreneurship and risk-taking. For this reason, tax policy should attempt to balance two different objectives:

a) achieving social justice, and

b) maintaining adequate economic incentives.

There are different answers to this issue in economic thought. Adam Smith supported the principle that a person's tax contribution should be related to their economic ability, while later liberal and monetarist economists, such as Milton Friedman, placed greater emphasis on the effects of high tax rates on economic incentives.

Progressive taxation, particularly when the entire income is taxed at the highest applicable rate, is a form of taxation that would disadvantage higher incomes and potentially benefit lower incomes, provided that the state redistributes the resulting revenue through social policy. On the other hand, one may criticize progressive taxation by arguing that it places a greater burden on certain categories of income and is therefore unfair, since higher income may not have been obtained without merit but may instead be the result of effort, achievement, etc. The well-known monetarist economist Milton Friedman, as well as other liberal economists, supported proportional taxation. However, Adam Smith himself supported progressive taxation, an idea he expressed in The Wealth of Nations.

The difference could be even greater. Within progressive taxation, there are two methods of applying this approach. One is to add together the amounts resulting from each tax bracket, as demonstrated above, while the other is to apply a single tax rate directly to the taxpayer's total income. Specifically, this would be the rate corresponding to the relevant income bracket. Let us explain this using the same example:

For example, income of 1,800,000 monetary units.

Based on the data in the table on page 180, this income would be taxed at 50% rather than 27.1%. This detail makes a difference when considering whether a tax is fair or not.

Therefore, there is no single tax combination that can automatically be considered ideal for every society. The effectiveness of a tax system depends on the economic structure, income levels, the extent of tax evasion, the quality of public administration and citizens' trust in the state. The objective is to achieve a balance: sufficient tax revenue to finance public needs, without allowing the tax burden to become so high that it undermines production, investment and economic activity.

8.3 Tax Evasion and Tax Avoidance as a Moral Hazard and Social Erosion

Based on the preceding discussion, one might argue that an income tax would clearly be a fairer tax compared with a consumption tax or perhaps even a property tax, and that a progressive income tax scale would be fairer because it could reduce extreme inequalities. Why, then, are consumption taxes such as VAT used on such a large scale?

In my personal assessment, it is the difficulty of collecting income taxes that leads policymakers to resort to such supposedly unfair taxes. I describe them as unfair because they have a horizontal character, meaning that they can impose the same rate of taxation across different levels of income. Regarding property taxation, we have also identified a possible weakness, since the high variability of property values during different phases of the economic cycle can create certain inequalities concerning whether a tax should be considered fair or unfair.

The difficulty of collecting taxes is related to a concept known as tax evasion. Tax evasion is the attempt by individuals to avoid their tax duties and obligations toward society in order to reduce their personal burden and the share that is attributable to them. The distinctive characteristic of tax evasion is that this attempt is made illegally rather than through lawful means. This characteristic distinguishes tax evasion from another concept that we will also examine in this section: tax avoidance, which involves the same intention but through legal means.

Tax evasion can take many forms. For example, it may include:

concealing income,

failing to declare economic activity,

failing to issue receipts,

issuing false or fictitious documents,

undeclared work,

concealing assets or income,

falsely declaring expenses, etc.

In all these cases, there is one common characteristic: the taxpayer attempts to illegally reduce their obligation toward the state.

In the first section of this chapter, we discussed the philosophical and historical background of taxation and the reasons why taxes exist. Without taxes, the state would not be able to organize society and promote the interests of society. Human beings, however, have an antisocial tendency by their very nature, at least to some extent, and place their personal interests above those of society. This leads them to seek to maximize their personal income and avoid sacrificing themselves for the benefit of society, that is, for the benefit of other people, because this is what society represents. Social values involve concern for others.

When the avoidance of this obligation is carried out through legal means, we speak of tax avoidance. By contrast, when it is carried out through illegal means, it constitutes tax evasion. These are the two concepts that we will analyze in this section. Both tax evasion and tax avoidance make it more difficult for the state to fulfill its responsibilities toward society.

Citizens often criticize politicians for unfair taxes or for the unfair way in which taxes are implemented. For example, perceived injustices in income taxation may concern the tax-free threshold, imputed income or the application of unfair tax rates that may place unequal burdens on different incomes.

As for property taxes, one could argue that they are unfair because they constitute an attack on the institution of private property, which can be regarded as a natural right of human beings, to refer to the English philosopher John Locke. If people lose their incentive to seek ownership, this could constitute a setback for the economy and its growth rates. It is similar to an employee losing part of their salary, which constitutes one of their basic incentives to work. Both labor and land or buildings are factors of production and should be equally supported by incentives capable of contributing to the successful completion of the productive process and the functioning of the economic system.

The greatest perceived injustice can be found in indirect consumption taxes such as VAT, which is a tax shifted from the business to the consumer and affects incomes indiscriminately, in the same way, whether the income is low or high.

These objections are entirely reasonable, but we should examine the issue more carefully and identify the actual causes of the phenomenon. People's tendency to avoid their obligations toward society is what forces the state to resort to such supposedly unfair measures and broad-based taxes, since tax evasion is more difficult in these cases. Of course, the argument may have some basis, since a capable government should be able to increase its tax revenues despite the existence of tax evasion.

The main causes of the phenomenon include:

The Level of Taxation

One factor that can affect tax compliance is the level of tax rates. Suppose that a professional earns an annual income of €60,000. If the total tax burden they face is relatively limited, they may consider that the economic benefit of concealing income is not worth the risk of a tax audit and the corresponding penalties.

By contrast, if they believe that a very large part of their income is taken through taxation, the economic incentive to violate the rules may increase.

This does not mean that high taxation justifies tax evasion. The illegal concealment of income remains illegal regardless of whether the taxpayer considers the tax fair or unfair. However, it shows that tax policy must also take human behavior into account.

Trust in the State

A second factor is the way in which citizens perceive the use of tax revenues. When citizens believe that their money is used effectively for healthcare, education, infrastructure, security and other public needs, they are more likely to view their tax obligation as part of their participation in society.

By contrast, when there is a widespread perception of waste, corruption, mismanagement or a lack of accountability, people's willingness to comply with tax obligations may decrease.

This creates a vicious cycle:

low trust → greater tax evasion → lower public revenue → greater pressure on compliant taxpayers → an even greater sense of unfairness.

The relationship can, of course, also work in the opposite direction. An effective and trustworthy state can strengthen public confidence and, consequently, tax compliance.

Tax Consciousness

In addition to economic calculations, there is also a dimension of tax consciousness. Tax compliance does not depend exclusively on fear of punishment. In a society where citizens

understand that taxes finance common needs, paying taxes can be viewed as an obligation toward society as a whole.

Education, knowledge of institutions and an understanding of how the state operates can contribute to the development of such an attitude. Tax education, therefore, concerns not only knowledge of tax rules but also an understanding of the relationship between taxation and public goods.[262]

Tax evasion refers to the illegal attempt by a person to conceal taxable income or avoid a tax that they are legally required to pay.

Tax avoidance, by contrast, refers to the use of lawful opportunities and choices with the purpose of reducing the tax burden. This distinction is important because not every attempt to reduce taxation is illegal. A citizen may legally make use of a tax deduction or choose a business structure provided for by law. It is different to conceal income or create false expenses in order to pay less tax.

Tax evasion can take many forms. These may include concealing income, failing to declare economic activity, failing to issue receipts, issuing fictitious or false documents, undeclared work, concealing assets or income, falsely declaring expenses, etc.

In all these cases, there is one common characteristic: the taxpayer attempts to illegally reduce their obligation toward the state.

By contrast, tax avoidance occurs when a taxpayer attempts to reduce their tax burden by using options permitted under the applicable legal framework. In other words, legally.

Examples of tax avoidance include:

making use of tax deductions provided by law,

using lawful tax incentives for investments,

choosing between different corporate structures,

planning the timing of certain transactions, [263]

making use of tax exemptions provided by law,

choosing a different tax residence, when this is genuine and complies with the applicable rules.

This raises an interesting ethical question: is something morally acceptable simply because it is legal?

---

[257] According to **Jean-Jacques Rousseau** and **Thomas Hobbes**, the social contract is the agreement through which citizens surrender some of their freedoms and rights to the state in exchange for protection, organization, and so forth. Part of these freedoms is also the income that citizens surrender in part in order to achieve the objectives of the state. This process takes place through the taxation of income.

[258] This refers to the well-known practice of **barter**: the exchange of one thing for another. At this stage, there was not yet money to mediate transactions, and exchanges took the form of direct exchange in kind. Later, early forms of money appeared, the so-called **commodity money**, before precious metals such as gold and silver eventually became money for practical reasons.

[259] This expresses the idea: **“Citizens pay in order for an organized state to exist.”**

[260] P. Rekleitis and A. Filis, *Tax Practice*, Third Grade of Vocational Lyceum (EPAL), Diophantos Publications, 2017.

[261] See Section 8.3.

[262] P. Rekleitis and A. Filis, *Tax Practice*, Third Grade of Vocational Lyceum (EPAL), Diophantos Publications, 2017.

[263] Such expenses may in reality concern personal expenses, but on paper they appear as an asset or expense of the company, which has a separate estate from that of its owner. Incidentally, the purchase of works of art may also constitute a tax-deductible expense.

CHAPTER 9 — THE ECONOMICS OF INEQUALITY: ETHICAL IMPLICATIONS

9.1 Economic and Moral Inequality

In this chapter, we deal with the problem of inequality, which is related to the taxation we examined previously. Taxation constitutes the basic mechanism through which the state attempts to redistribute wealth, together, of course, with public expenditure, through which it attempts to provide citizens with public goods and services.

Inequality means that wealth is accumulated unequally by certain individuals/private persons, and this has the consequence of worsening the fundamental economic problem that we examined in Chapter 2.

Let me remind the reader once again that the fundamental economic problem arises from the fact that the resources available for the production of economic goods are limited, whereas human needs are unlimited. It is essentially a problem of scarcity of the factors of production: **labor, land, capital, and entrepreneurship**.

The accumulation of money in a few hands means that purchasing power becomes concentrated in a few hands, together with the corresponding share of real wealth. This makes the consequences of the economic problem worse and gives them a stronger impact on society.

Therefore, there are two factors that influence this problem:

1. **Overpopulation**
2. **Inequality of wealth**

One could argue that economic inequality originates from moral inequality and is a product of exploitation, corruption, injustice, and so forth.

Certainly, moral education of citizens and society could help. It would mean that people themselves perform the role of the state, without the existence of a state or authorities to impose these obligations upon them.

Respect for workers' rights, protection of the right to social insurance, assistance to the weak, and care for nature and animals could narrow the gap of moral inequality and, at the same time, economic inequality.

Furthermore, when people lack social and moral values, the state itself will also become an immoral state that reproduces inequality and exploitation—not necessarily intentionally, but as the final result of actions whose purpose is to promote the individual interests of politicians.

The schools of ethics that we examined in the first chapter, and particularly the moral philosophy of those associated with **deontology** and **virtue ethics**, can have a decisive positive effect on society:

- **Immanuel Kant — Deontology**
- **Plato and Aristotle — Virtue**
- **Adam Smith — Virtue based on sentiment/sympathy**

The value of these schools of ethics is indisputable, and one of the fundamental purposes of this work is to connect economics with **virtue ethics**, which appears to have been the objective of the father of economic science himself, **Adam Smith**, as we demonstrated in Chapter 6 when discussing the apparent incompatibility between his two works.

However, it would not be correct to expect individuals to follow moral principles selflessly without receiving any personal benefit. We must appeal to people's **self-love and personal interest**.

Those who have understood this achieve their objectives more successfully.

We previously discussed the role of the state, that is, the government, in inequality. Inequality does not arise exclusively from voluntary actions taking place within a free market and a free society; it is also strengthened and maintained by the state itself, without whose intervention these inequalities might perhaps not be sustainable over time.[266]

Why does this happen?

Because a normative theory is not sufficient by itself to persuade individuals to do their duty. It requires a positive-descriptive theory as a necessary complement.

Let us see how an ethical normative theory fails when it does not take into account the basic economic principle and methodological individualism through an example: **the agency problem**.

The agency problem is a term from business administration and refers to the phenomenon observed in large companies and organizations, where executives and top management tend to promote their own interests, placing them even above the interests of the shareholders, whose interests they are supposedly trying to serve by maximizing profits and the value of their assets.

For example, they may create luxurious offices for themselves, charge personal expenses to the company, and so forth, at the expense of shareholders.

These phenomena can be explained if we take into account the assumption of **methodological individualism** and the basic economic principle associated with the school of **Utilitarianism**.

Each shareholder of the company is interested primarily in personal profit and not necessarily in what is morally right.

Therefore, if each shareholder owns only a small part of the company's total property, they have no strong incentive to concern themselves with limiting waste and improving the company's efficiency.

Their personal share of the profits is not sufficient to motivate them to become genuinely concerned with the interests of the company.

This gives executives the opportunity to burden the company for their own benefit.

The same agency problem appears, in the same way, in the **political market**.

If we place the people in the role of shareholders and the government in the role of management, we observe exactly the same phenomenon: governments and politicians generally tend to place their personal interests above the interests of society and the citizens whom they are supposedly representing.

The benefit to the individual citizen is not sufficiently large to persuade them to become concerned with the efficiency of government. This gives politicians the opportunity to exploit the situation and obtain privileges for themselves.

This is also one reason why moral principles have become so weak in society.

They do not provide a direct profit.

People do not respect honest, virtuous, and just characters, but rather wealth, power, physical attractiveness, and so forth.

Personal, professional, and social success is not achieved by virtuous characters, but by **Machiavellian** ones.

If society lacks moral principles, the government and the state themselves will also lack moral principles, since they emerge from that very society.

As mentioned earlier, we must appeal to personal interest.

From this perspective, it is not sufficient to ask politicians and society to possess moral principles selflessly. We must examine the incentives offered to them to perform their duties.

The main incentives that attract someone to become a politician and acquire political power by forming a government are:

- power;
- the high income associated with the position;
- special privileges;
- free travel;
- personal security;
- cars;
- and so forth.

These incentives, however, do not attract virtuous characters. They attract ambitious, competitive, selfish, and money-oriented individuals.

They may be good incentives for certain businesses in a free market, but the role of a politician is different.

The politicians we would ideally like to have may need different incentives, such as free access and benefits at museums or bookstores, free access to products relating to animal care, and, more generally, social acceptance.

In some cases, the financial incentive itself may even discourage someone from entering politics.

However, I would like to return to an issue I mentioned earlier.

We stated that the factors that worsen the economic problem are **overpopulation and inequality**.

Overpopulation itself generates inequality because it creates an economic problem.

All these factors are interconnected.

With regard to population, population growth was quite low for many centuries, but productive capacity was equally limited.

During the historical period around 1800, the views of **Thomas Malthus** became particularly influential. He referred to what we call the **Malthusian Trap**.

The “Malthusian Trap” is a theory developed by Thomas Robert Malthus in the late eighteenth century.

Malthus argued that:

- population increases very rapidly, **geometrically**;
- whereas food production increases more slowly, **arithmetically**.

Therefore, at some point, population exceeds available resources and society falls into poverty, hunger, and crises.

This is the “trap.”

If the number of people continuously doubles but food is insufficient:

- unemployment increases;
- wages fall;
- famines or diseases appear;
- and eventually the population decreases again.

Malthus believed that this cycle repeats itself.

Even if a society temporarily becomes wealthier, population growth “eats away” at economic development and most people return close to subsistence level.

The theory had a major influence on economics and demography, but the **Industrial Revolution** demonstrated that technology can dramatically increase the production of food and goods.

Population growth ceased to constitute the same kind of problem because modern technology, capital, and infrastructure allowed production to expand spectacularly.

Consequently, the additional human needs were more than compensated for by the additional wealth created by these individuals, thanks also to the use of technology.

In Chapter 10, we will return to this issue and to technology and will see, through an example from economics, how population growth cannot continuously lead to a corresponding increase in production.

This is why the **Malthusian Trap** returns and continues to haunt humanity.

If resources are insufficient to feed an ever-growing population, we can understand why inequality may become stronger.

When there is a real danger and survival is threatened, it is entirely logical for people to accumulate continuously and attempt to secure their survival.

A welfare state that establishes the limits we discussed in previous sections could help individuals feel the security they need and might perhaps serve as a substitute for their need for insatiable wealth accumulation.

This constitutes an argument in favor of the ideology of **social liberalism**, which combines both the free market and competition with the welfare state in order to combat social injustices.

9.2 When Does Inequality Become Morally Unacceptable?

> “We have enough goods to satisfy everyone's needs, but not everyone's greed.”
>
> — **Mahatma Gandhi**

> “Inequality is not a problem that requires charity, but justice.”
>
> — **Jacques Diouf**[267]

Inequality and the insatiable thirst for the accumulation of wealth become the great problem that comes to haunt humanity.

In our time, inequality has increased to such an extent that a handful of people possess more wealth than entire populations, and this is not the only form of inequality.

The social mobility that characterizes Western societies has created multiple inequalities even at lower income levels.

How fair can this be for humanity and human rights?

When people are deprived of income, every discussion about rights, equality, freedom, and so forth loses its meaning.

Why is it considered morally right, and therefore just, for some people to enjoy goods and services from which other people are excluded?

According to the Constitution, as well as the human rights that shaped it, do we not all have the same rights?

We have already discussed this issue.

We examined the views of those belonging to the liberal tradition as well as more socialist perspectives.

For example, we examined the philosophy of **John Rawls**, who attempts to combine income inequality with a concept of equality and justice.

We discussed clear limits that it is beneficial for an organized and civilized society to establish if it wishes to consider itself humane.

Today's levels of inequality are a disgrace for humanity.

Obviously, it is neither fair nor economically efficient to increase the incomes of those who are unproductive for the economy, nor is it appropriate to reward unemployment with excessively high benefits.

However, this is different from having no limits whatsoever on levels of wealth or competition, to the point where human lives are even lost because of poverty.

If we exclude the Western world, there are many countries that remain on the edge of **absolute poverty**.[268]

The current level of inequality cannot simply be the result of an economic theory that rewards with higher profits those who contribute more to the economy, or serves as compensation for the difficulties associated with a profession that is nevertheless necessary and therefore must be compensated with higher remuneration in order to attract the necessary labor.

Free-market economists attribute inequality to market imperfections and weak competition.

Market structures such as **oligopoly and monopoly**, which we examined in Chapter 2, generate inequality by themselves.

Inequality can also be caused by inflation itself.

During an inflationary crisis, production collapses while demand is disproportionately high in relation to the supply of goods.

This requires everyone to lower their standard of living and make sacrifices.

However, in such a situation, those who are able to maintain their standard of living by shifting this cost onto other incomes will do so.

This is usually easier for private individuals—companies and self-employed professionals—who can easily adjust the prices of their goods upward thanks to the flexibility of the free market.

By contrast, for employees and public-sector pensioners, this adjustment occurs more slowly.

In general, inflation affects fixed incomes, such as those of bondholders who receive fixed interest payments, whereas equity investors may see dividends increase in nominal terms.

This means that they may preserve their real value or even exceed previous levels, since inflation can provide an important opportunity for such redistributions of income.

Another form of redistribution in a free economy is produced by the phases of the **business cycle**.

The expansionary phases are associated with the inflation we mentioned, while the contractionary and recessionary phases compress incomes, particularly labor incomes.

A recession also creates new investment opportunities because prices fall in countries facing crisis.

Certain private interests discover the business opportunity they need to dramatically increase their profits and wealth.

Speculators are the first to invest in these troubled countries and become the new dominant economic actors.

In previous chapters, we discussed the **natural price** of commodities.

When negotiations and the struggle between competing interests are unequal, the distribution of income in the economy will also be unequal.

For supporters of the free market, inequality constitutes the necessary incentive that creates wealth and prosperity in society.

However, this inequality, especially when combined with the absence of the limits I proposed in the previous chapter, leaves individuals with no alternative but to engage in insatiable and greedy accumulation of wealth, since there is no other protective limit for individuals.[269]

Inequality as a necessary incentive for economic activity is not convincing by itself.

Only if there is a redistribution system involving **high progressive taxation**, which distributes wealth from the strongest toward the poorest, can we observe the true effect on incentives.

From experience, however, we observe that economic activity does not freeze simply because profits fall—whether we are referring to business profits or labor income.

In some cases, economic activity may even receive a boost, as individuals attempt to maintain their previous level of well-being.

The unacceptable level of inequality becomes even more evident if we consider the relationship between **happiness and income**.

There are mainly two important studies concerning this issue.

1. The Classic Study (2010)

Daniel Kahneman and Angus Deaton found that in the United States, daily emotional well-being increased with income up to approximately **$75,000 per year**, after which it appeared to stabilize.

In other words, the marginal happiness produced by each additional unit of income is high at lower income levels and decreases as income rises, until it eventually stabilizes.

Life evaluation—"How satisfied am I with my life?"—continued to increase beyond this level and could also be attributed to non-economic factors, such as good health, a sense of achievement in life, and so forth.

2. The Revision (2021–2023)

Matthew Killingsworth found that happiness continued to increase even at high income levels.

Subsequently, the researchers themselves collaborated in order to resolve their disagreement.

Some researchers place the threshold at approximately **$200,000**.

Their common conclusion was that:

- For most people, well-being continues to increase as income increases.
- For a smaller group of people who are particularly unhappy, the benefits of income appear to reach a ceiling after a certain point.

Nevertheless, the role of money should not be underestimated.

The way money is managed and whether people's financial priorities correspond to what they actually value are also highly important.

Money can provide:

- security;

- protection;
- freedom;
- more time;
- and so forth.

Higher income is particularly beneficial when it covers basic needs and reduces the anxiety associated with financial insecurity.

After a certain level of comfort has been reached, each additional euro usually provides a smaller increase in happiness than the previous ones, while factors such as relationships, health, and social cohesion often have an equally important or even greater influence on overall well-being.

9.3 Toward a New System of Income Redistribution

The problem of inequality is one of the greatest problems facing humanity, perhaps even the greatest of all.

The international community should take measures to address a phenomenon that magnifies the economic problem and makes its consequences considerably more severe.

Countries compete with one another to attract capital, which is indeed a precursor to prosperity, and in this effort they make many concessions in favor of capital.

Such concessions include:

- tax exemptions;
- low wages;
- exhausting working hours;
- and so forth.

The freedom of capital, to some extent and for certain categories of income, allows those with high incomes to minimize their duty and obligation to contribute to the community in which they live, even though they are the ones with the greatest ability and capacity to contribute compared with lower-income and poorer citizens.

At present, we have a system that achieves the opposite.

The poor are not recipients of assistance from the state financed by the wealthy.

Instead, they themselves pay high taxes, whereas they should be recipients of state assistance.

We saw earlier, for example, how **VAT can become a regressive tax** that disproportionately burdens lower incomes.

This international cooperation could mean establishing minimum standards concerning taxation and the conditions granted to capital.

These standards could be supervised by a global organization responsible for ensuring compliance —for example, the **IMF**, the **World Bank**, or some global organization originating from a country other than the United States.

However, as we have seen, taxation creates reactions among taxpayers who wish to avoid their obligations, through tax evasion, tax avoidance, and so forth.

Taxation proves inadequate as a means of combating inequality because it presupposes state intervention and therefore coercion.

People always tend not to accept restrictions on their freedom and are characterized by self-interest.

They do not willingly accept contributing to others without personal benefit.

Indeed, to some extent, forcing them to do so could constitute a violation of human dignity and personality and could be morally inappropriate.

On the other hand, this freedom cannot be left completely uncontrolled to the point where people's survival is threatened.

Basic survival needs must be guaranteed by the state.

After all, this is also a fundamental human right established by the **United Nations Declaration of Human Rights**.

Examples of such survival needs are the needs corresponding to the first two levels of **Maslow's hierarchy of needs**, which we discussed in previous chapters:

1. **Physiological needs**
2. **Safety needs**

A new system must therefore be found that is compatible with the free market and through which redistribution occurs spontaneously, without oppressive measures.

What I would personally like to propose is a system resembling the regime of **floating exchange rates** that exists in international political economy and functions as a mechanism for balancing the balance of payments between national economies.

In a similar way, there could be an equilibrium mechanism for individuals or individual economic units, such as households and businesses.

In Chapter 2, we examined some basic concepts of economics.

We examined the supply and demand curves of an economy and presented relevant diagrams.

However, these curves concern the total market supply and demand and not the individual curves of each separate consumer or producer.

The market curve is the sum of the individual curves.

Therefore, an equilibrium between them in the market does not automatically mean equilibrium for each individual economic entity, such as an individual or a household.

It is therefore a general equilibrium that emerges as a result of the exclusion of particular groups and economic units, individuals, and households.

I consider this to be a problem for an economic science and a theory of price equilibrium that supposedly connects with classical liberalism.

Classical liberalism is based on certain moral principles, one of which is **individualism**.

The market, however, does not concern the individual but the aggregate.

Therefore, equilibrium at the aggregate level does not automatically mean equilibrium at the individual level.

When an individual's demand curve increases, the entire curve should shift upward and to the right, toward a level of greater consumption and higher prices.

This does not happen, however, because prices reflect the equilibrium of total market supply and demand.

Consequently, prices remain stable at a level that favors market equilibrium, but not necessarily the equilibrium of each individual separately.

The practical application of such a system is an issue that requires research or experimentation.

I do not claim that such a system is necessarily feasible in practice.

However, it could potentially be implemented with the appropriate administrative and technical infrastructure by an organized state.

Earlier, we compared it with the system of floating exchange rates that operates in international payments.

Therefore, just as there is an external appreciation or depreciation of the currency of a national economy, in our case there would be an **internal depreciation of the value of money** that would not concern all economic entities in a national economy but would affect only a particular individual.

There would therefore have to be an increase in prices and inflation that applied to the individual rather than to the economy as a whole.

Perhaps this could be achieved through some form of **negative-discount coupons**, whereby purchases would generate a coupon that, instead of providing a discount, would impose an additional charge.

Conversely, discounts could be granted through electronic payments when it is established through interbank information that expenditure on specific categories of goods or services is at very low levels.

In any case, the purpose of such a system would not be the accumulation of profits and inequality, but to find a way of redistributing income—or at least creating a tendency toward equilibrium and equality of incomes—spontaneously, without oppressive and interventionist measures requiring individuals to act selflessly.

Such selflessness ensures the ineffectiveness of these redistributive mechanisms.

However, I am not claiming that the fiscal measures of taxation and public expenditure should be abolished or replaced.

The new system would be a **complement**, not a substitute, for the existing redistribution system.

It would aim to address weaknesses in revenue collection caused primarily by taxpayers' reactions.

Before closing this chapter, it is worth briefly explaining what **floating exchange rates** are in international payments, since this is what we used earlier as an analogy for the proposed system.

Floating exchange rates mean that a currency acquires greater or lesser value depending on whether it comes from a surplus or deficit economy.

If an economy is in surplus, the cost of its products in foreign currencies increases, thereby discouraging further capital inflows into that economy.

Conversely, when there is a deficit, the currency depreciates and products become cheaper for foreign incomes denominated in foreign currency.

The economy therefore becomes more competitive and capital inflows are encouraged.

It is a mechanism of automatic equilibrium, but it concerns the **external value of the currency**, rather than its internal value.[270]

Let us look at a simple example.

A simple example of a floating exchange rate is the exchange rate between the **euro and the US dollar**:

- Today, 1 euro may equal **1.10 US dollars**.
- One month later, due to changes in supply and demand in foreign-exchange markets, it may become **1 euro = 1.15 dollars**.
- Later, it may fall to **1 euro = 1.05 dollars**.

Under a floating exchange-rate system, the price of a currency is not determined by the government or the central bank but changes according to factors such as:

- interest rates;
- inflation;
- economic growth;
- investment flows;
- market expectations.

Example

If a Greek company purchases products worth **$10,000**:

- at an exchange rate of 1 euro = $1.10, it will need approximately **€9,091**;
- if the exchange rate changes to 1 euro = $1.00, it will need **€10,000**.

Therefore, floating exchange rates directly affect the cost of imports, exports, and international transactions.

---

[266] The source text contains an incomplete footnote beginning with the example: “For example, government intervention in the foreign-exchange market may …”. The continuation is not fully recoverable from the extracted text of the provided PDF, so I have not invented or reconstructed the missing wording.

[267] Jacques Diouf was a Senegalese diplomat, politician, and agronomist. He became best known as Director-General of the **Food and Agriculture Organization (FAO)** of the United Nations, a position he held from 1994 to 2011.

[268] Absolute poverty is a condition in which an individual or family does not possess the necessary resources to meet basic survival needs: adequate food, clean water, basic shelter, basic clothing, and basic healthcare.

[269] See Section 7.3, p. 173.

[270] This was the case while the **gold standard** existed, which was also an alternative regime for balancing payments. Under this system, exchange rates did not change, but capital outflows or inflows resulted in a fall or rise in the price level and therefore also in competitiveness. This was ensured by a fixed quantity of money corresponding to the quantity of gold.

CHAPTER 10 — TECHNOLOGY, ARTIFICIAL INTELLIGENCE AND NEW ETHICAL RISKS

10.1 The Contribution of Technology to Addressing the Fundamental Economic Problem

In Chapter 10 and the sections that comprise it, we discuss technology, something that I consider very important and that should not be omitted. In my view, technology should be utilized and should not be treated as a threat to human independence. Many people see technological development as a threat that will make many professions unnecessary, and consequently people will lose their independence, since they will no longer have their own income and will depend exclusively on the state and whatever subsidies it may provide.

This is also connected with the issue of **inequality** that we discussed in the previous chapter.

I believe that technology should be viewed as a means of improving people's lives rather than as a threat to humanity. The question is not whether technology itself is good or bad, but **how it is used and who benefits from it**.

We often hear politicians talking about a “magic wand” when they are asked to account for their performance and their effectiveness in addressing problems in society and the economy. If such a “magic wand” exists, it could be nothing other than **technology**, and for this reason its usefulness is enormous and it is worth dedicating an entire chapter to it.

Technology does not merely expand the productive capabilities and profits of an economy. It can also make people's lives better by giving them the opportunity to perform the same task with fewer sacrifices, whether these sacrifices concern labor or other factors of production, and above all **time**.

Even **Karl Marx** emphasized this positive aspect of technology and did not view its development as a threat, as many trade unionists or politicians do today when they invoke his name. These people see technological development as a danger because of the loss of jobs that may result in increased unemployment, loss of income, and consequently the compression of the wages of the remaining workers.

Workers could also lose their independence because they would become entirely dependent on a government or the state and would no longer possess their own income.

We will examine this issue further in the next section, where we will consider the new challenges arising from **artificial intelligence**, which represents the latest stage in the scale of technological development.

Before examining this, however, let us make a historical overview of the impact of technology on the economy and see why it plays such an important role in society.

The phase of technological progress that we are currently experiencing is also known as the **Fourth Industrial Revolution**. What were the previous ones?

The four Industrial Revolutions describe the major waves of technological and productive changes that transformed the economy and society.

The First Industrial Revolution — approximately 1760–1840

It was based on the mechanization of production through the **steam engine** and contributed to:

- the use of steam as a source of energy;
- the development of the textile industry;
- the creation of factories and industrial production;
- the development of railways and steamships.

The Second Industrial Revolution — approximately 1870–1914

It was characterized by **electrification and mass production**.

Its principal characteristics included:

- electricity;
- assembly lines;
- steel and chemical industries;
- the telephone and telegraph;
- the development of automobiles.

Important figures included **Thomas Edison** and **Henry Ford**.

The Third Industrial Revolution — approximately 1950–2000

It is also known as the **Digital Revolution**.

Its principal characteristics included:

- computers;
- microprocessors;
- automation of production;
- telecommunications;
- the Internet.

The **Fourth Industrial Revolution** concerns the historical period in which we currently live, and we will examine it further in the next section.

We have already discussed some of the benefits of technology. One of them is that it expands the productive possibilities of an economy and can therefore provide either higher profits or the peace, tranquility, and comfort that modern human beings need in order to escape the intense pace of contemporary life.

One issue concerning technology is **how it is used and how it is exploited**: whether it is used simply to maximize profits or whether it is used to provide us with the same level of prosperity with fewer sacrifices.

A tool that helps us understand how technology expands the productive possibilities of an economy and what this means is the well-known **Production Possibility Frontier (PPF)** from economics.

The supply curve of goods in an economy also concerns the technological relationship between the good produced and the cost of producing it.

These concepts could have been mentioned in Chapter 2, but no relevant reference was made at that time.

Let us therefore make a brief reference to the PPF through a simple example.

Example

Suppose that a country produces only **wheat and automobiles**.

Combination	Wheat (tons)	Automobiles
A	100	0
B	80	20
C	60	35
D	40	45
E	20	50
F	0	52

If the country moves from combination **B** to combination **C**, it produces:

- 20 fewer tons of wheat (80 → 60);
- 15 more automobiles (20 → 35).

This demonstrates **opportunity cost**: in order to obtain more automobiles, the country must sacrifice part of its wheat production.

The relationship is also represented in a diagram, with the axes showing the two goods, which we use here indicatively.

Through this model, however, we can understand the broader effect and logic.

Normally, this curve is **concave to the origin**, and this reflects production relationships that are not constant. Furthermore, workers are not equally suitable for producing both goods.

An improvement in technology causes the entire **production possibility frontier to expand**, whereas deterioration in technology causes it to contract.

This gives the economy the opportunity either to produce combinations of goods that it previously could not produce or to produce the same goods while consuming fewer hours of labor and making fewer sacrifices.

Combinations located to the **left of the PPF** are considered feasible, whereas those to the **right** are considered infeasible.

A change in technology shifts the entire curve and therefore combinations that were previously feasible or infeasible may become infeasible or feasible.

The combinations located directly on the curve represent the production possibilities available when the economy fully utilizes its productive resources.

In the diagrams, we can see two of the most common cases:

1. The factors of production are not equally suitable for producing both goods.
2. The factors are equally suitable and production relationships are constant if the ratio is 1/1, or they may not be equally suitable and the ratio may be different from one. However, the production relationships remain constant.

Through this analytical tool, we understand how important technology is to the economy.

It can increase profits and reduce the sacrifices required to achieve production.

Nevertheless, as we saw earlier, there is a danger of **unemployment and loss of independence**.

In Chapter 2, we examined the fundamental questions with which economics is concerned, and one of them concerned the way in which goods are produced.

There are economies that prefer the **full employment of everyone**, in order to secure their income and independence.

There are also economies that, through the use of modern technology, employ fewer people in order to achieve the same or even greater wealth.

Usually, we see the first form of economy in **communism**, whereas the second is associated with **capitalism**.

However, as we saw at the beginning of the chapter, Karl Marx himself desired the utilization of technology in order to reduce employment—something in which he saw an escape from what he regarded as exploitation—and to provide people with more free time for the fulfillment of broader intellectual and human needs beyond material needs.

The book then refers to statistical research showing that economies with better technology are able to achieve economic results with fewer sacrifices or lower costs.

It also observes a tendency for a comparatively smaller part of the labor force to be employed in the primary sector, followed by the secondary sector and then the tertiary sector:

Tertiary > Secondary > Primary

Let us now see how technology makes it possible to produce goods that previously lay at the boundary of an infeasible combination.

As we saw, the **First Industrial Revolution** took place in the eighteenth century.

At that time, there was intense concern about overpopulation and the problem of insufficient production of goods.

This is also known as the **Malthusian Trap**.

The Malthusian Trap is a theory formulated by **Thomas Robert Malthus** at the end of the eighteenth century.

Its basic idea is that:

- population tends to increase faster than food production;
- when production increases and living standards improve, population grows;
- population growth eventually consumes the additional goods and resources;
- therefore, most people return to standards of living close to subsistence.

Example

Imagine an agricultural society with 100 inhabitants and sufficient food for everyone.

1. A new agricultural technique increases food production.
2. People are better nourished, mortality decreases, and births increase.
3. The population grows to 150 or 200 inhabitants.
4. Food per person decreases again.
5. The standard of living returns approximately to its original level.

This vicious cycle is the **“trap.”**

Why is it called a trap?

Because any increase in income or production ultimately leads to an increase in population rather than to a permanent improvement in people's welfare.

Only after the **Industrial Revolution** was the Malthusian Trap overcome, demonstrating that something which had previously been impossible before technological development could eventually become possible.

This progress, however, resulted in a major increase in population, with population growth becoming exponential.

Global population growth accelerated significantly over time.

For example, while humanity needed approximately **2,000 years to reach its first billion inhabitants**, the second billion was added within 130 years, the third within 30 years, the fourth within 15 years, and the fifth within only 12 years.

The population continued to increase rapidly, soon approaching the next billion.[269]

Overpopulation and the depletion of natural resources create new challenges and problems.

The **Malthusian Trap returns to haunt humanity**, and a new Industrial Revolution is approaching.

10.2 The Future of Work and Human Dignity

History often has a tendency to repeat itself, and a new Industrial Revolution has now arrived to be added to those we mentioned earlier: the so-called **Fourth Industrial Revolution**.[270]

It is the era in which “smart” technologies enter every aspect of life:

- industry;
- everyday life;
- healthcare;
- services;

and everything becomes interconnected through **data and the Internet**.

Some of its particular characteristics are:

- **Artificial Intelligence (AI) and machine learning**
- **Robotics and production automation**
- **Internet of Things (IoT)** — devices that communicate with one another
- **Big Data** — analysis of enormous quantities of data
- **Cloud computing** — storage and processing in the “cloud”
- **3D printing**
- **Biotechnology and genetic engineering**
- **Autonomous vehicles**

In the previous section, we compared technology with a **magic wand**, which allows us to accomplish things that once could exist only as ideas in science-fiction films.

Artificial intelligence makes it possible to process large quantities of data, extract information, and create goods at significantly lower cost, without the need for human labor.

The same applies, of course, to **robotics**, through which many jobs that are currently tedious for human beings could be performed by machines, potentially at a lower cost, something that would increase productivity.

Furthermore, machines possess capabilities that exceed human capabilities.

This is what is known as **production automation**.

Such cost savings expand the supply curve of goods in the economy and result in lower prices and increased output.

The extent to which technology can develop is extraordinary. It goes beyond the dreams that, for example, primitive human beings could ever have imagined.

Human beings could even develop abilities resembling **telepathy**.

A series of technologies could be developed, such as **haptic virtual reality**, which already exists in various games where the player has the ability to see and feel directly what is happening.

If such a capability were developed, it could constitute the perfect form of **empathy**, in which people feel the pain of others as if it were their own, demonstrating that economics can be identified with ethics.

Artificial intelligence, which we mentioned at the beginning, is the most important technology, and it is not accidental that there is such a large amount of investment in it by all the major companies in the industry.

Another technology on which I would like to focus is **3D printing**.

3D printing, or **Additive Manufacturing**, is a method of producing objects in which material is added layer by layer until the final object is created.

This differs from traditional methods, in which material is usually removed from a larger piece—for example, through turning or milling.

It works as follows:

1. An object is designed using a **CAD (Computer-Aided Design)** program.
2. The design is converted into hundreds or thousands of thin layers.
3. The printer constructs each layer sequentially.
4. The layers are joined together and form the final object.

This is a technology that could contribute to increasing the supply of a range of products.

However, I would particularly like to mention the contribution it could make to the construction of **housing**, something that could provide a solution to the housing problem and strengthen the economy.

Through this technology, the supply of housing could increase, reducing costs and prices and making housing accessible to a larger part of the population.

There are already real homes that have been constructed through 3D printing and are inhabited by people, although the technology is still at a relatively early stage.

At present, this technique can be seen in the **United States, Russia, and Dubai**.

More specifically:

- In the United States, the company **ICON** has constructed neighborhoods with 3D-printed houses in which people live normally.
- In Russia, the company **Apis Cor** printed an entire small house in only 24 hours, referring to the basic walls.
- Dubai has invested heavily in 3D printing of buildings.
- There are offices and public buildings containing 3D-printed elements.
- The city's objective is to reduce construction costs and construction time on a large scale.

Another technology that promises changes for the future is the creation of **autonomous vehicles**.

These are vehicles capable of moving autonomously without human intervention or guidance.

This means that in the future driving could become something like an elevator: you press a button and it automatically transports you.

As we can see from this last example, as well as from every case involving technological progress, the prospect of greater wealth and increased profits comes with a cost: the **loss of human independence caused by the loss of jobs threatened by technological development**.

If jobs are automated, there will be no need for human labor, or employment will be reduced.

This will lead to loss of income.

For example, in the case of autonomous vehicles, many taxi drivers or other vehicle drivers could lose their jobs or see their revenues reduced.

Many people see this as a danger for the new era that is approaching.

Such a prospect might not have troubled **Karl Marx**, who regarded labor as exploitation and desired to find a way to limit this exploitation.

Personally, I would welcome such a development.

Nevertheless, state subsidies are necessary to support weaker incomes if machines are now producing the wealth.

This should not be regarded as a threat but as an opportunity for a better future, allowing humanity to take another step forward.

It is not only vehicle drivers whose jobs are threatened by unemployment.

Many other professions may face this problem, including:

- farmers;
- publishers;
- cashiers;
- travel agents;
- bank employees;
- professional soldiers;
- fast-food employees;
- telemarketers;
- stockbrokers;
- accountants;
- and so forth.

This trend is already visible.

For example, we can think of the contraction of the banking sector, where almost all services are now offered electronically through **e-banking or mobile phones**.

Bank accounts can now be opened through mobile phones without requiring any human labor.

The same could happen in **education**, where modern tools are already simplifying the teaching process.

In such cases, people are required to find alternative forms of employment, something that may have broader socioeconomic consequences.

Farmers had already suffered a major blow from the **First Industrial Revolution**, when technological development made their labor unnecessary and resulted in their migration to cities for industrial and factory employment.

At the same time, the Industrial Revolution improved transportation, and many people became involved in trade.

I would like to conclude this section by expressing my personal view.

I believe that **technology itself is positive**, provided that it is used properly and that state regulation exists where necessary.

If machines can reduce the need for human labor while the state supports incomes, then this does not constitute a threat to humanity.

It could perhaps also address the problem of **inequality** to some extent, since there would no longer be the same need to motivate workers through higher remuneration.

The issue is whether automation and artificial intelligence will benefit **society as a whole or a particular elite that owns the capital**.

---

[269] N. Iliadis and G. Voutsinos, *Technology, First Grade of Vocational Lyceum (EPAL)*, Diophantos Publications, 2022.

[270] The term became particularly well known through **Klaus Schwab**, founder of the **World Economic Forum**.

Chapter 11 — An Alternative Approach to Markets

11.1 Human Well-Being versus Efficiency?

There is a quotation attributed to Plato according to which Plato seems to have believed that it does not matter to be rich, but rather to live well. Indeed, the accumulation of excessively high wealth may appear to third parties as something good for the person who possesses it, yet it may lead to a lower level of well-being and happiness.

In previous chapters, we referred to income thresholds and the corresponding research demonstrating the validity of this argument. Naturally, when someone has zero income, an increase in income or an abundance of wealth in an economy that increases their purchasing power will greatly improve their level of well-being. However, marginal utility tends to decrease as the level of income increases and, above a certain threshold, may cease to have any effect at all. We saw that some place this threshold at $70,000, while according to other studies it is $200,000.

This chapter could also be associated with Chapter 5, where we examined the effects of profit on society and the economy. The unrestricted pursuit of profit has certain negative side effects on society. It may have the positive effect of constituting the strongest incentive for development and economic activity; however, it is true that it also has certain side effects or unintended consequences. These consequences do not concern only the destruction of the natural environment or the depletion of natural resources, etc., but also the very culture and morality of society, which are negatively affected.

Business interests have promoted a lifestyle and certain moral values that shape the profile and behavior of the modern consumer in ways that benefit those interests and maximize their revenues. However, this excessive consumption results in the creation of a shallow society without substantial principles and values, a superficial society that no longer emphasizes people's character but only appearances. There is no other value that can now be compared with money and material wealth, and this appears to be the dominant criterion of success.

I would like to associate this section with the schools of ethics that we examined in the first chapter, but first I would like to focus on the purely economic aspect.

We speak of efficiency. What is efficiency? Efficiency in economics, and particularly in business management, is the measure that indicates the degree to which a business unit achieves the objectives it has set. There are institutional and operational objectives, that is, objectives at a more general theoretical level and objectives that are measurable and concern specific numerical achievements. These two levels of objectives can, of course, be interconnected.

When an investment is made or a business is established, a business plan is prepared and planning takes place, during which the business sets certain objectives. This is done by the company's senior management. For example, if a company sets a target of increasing sales by €1,000 and achieves an increase of €900, then its degree of efficiency is:

Efficiency = 900 / 1,000 × 100 = 90%

This could be an operational objective that assists in a possible expansion of the business into another geographical area, which could constitute the institutional objective. If we were to express it mathematically, it would be:

Efficiency = Units Achieved / Units Targeted

Efficiency can subsequently be associated with a series of other financial ratios and management indicators. From these basic figures, more detailed financial indicators arise, such as ROE (return on equity), which measures net profit in relation to equity capital, that is, the capital invested by shareholders and not obtained from an external source such as borrowing. The corresponding mentality also applies to public administration and the formulation of government policy. Undoubtedly, an economic unit or a national economy that manages to maintain these indicators at acceptable levels ensures its financial health, just as blood tests reveal the state of a patient's health.

However, this exclusive focus on economic objectives may have adverse effects on levels of human well-being, and when this happens, the original objective is ultimately lost: human happiness, rather than the maximization of economic benefit, which is not the only factor determining happiness.

At the level of the national economy, if a successful economic policy results in a major reduction in wages or attracts investments that prove toxic and harmful to the environment, or creates financial bubbles with destructive consequences for the economy and lower-income groups, then this does not improve the level of human well-being.

Furthermore, at the purely economic level, such a mentality can often undermine the quality of the economic product itself. According to the basic economic principle, the objective is to achieve the maximum possible profit with the minimum possible sacrifice. Such an approach can often reduce quality in the attempt to achieve this objective.

A characteristic example was seen in the example of bad lemons, as well as in the prisoner’s dilemma, where we demonstrated that speculative transactions, when they replace human relationships, can be harmful to society as a whole. In other words, the group as a whole is harmed for the potential improvement of the self-interest of a single member of the group. This is therefore an excessively selfish behavior that should not be encouraged.

Furthermore, we demonstrated that this objective of efficiency leads us to ignore the needs of society and to place personal benefit above social benefit.

Of course, I am not claiming that the well-being of society should be the exclusive criterion, especially when economic decisions are being made. It could be the criterion when it concerns policy decisions, but not economic decisions, such as where someone should invest or where they should obtain the raw materials they need. In such decisions, the criteria of maximization, efficiency, effectiveness and the economic principle do indeed appear to maximize the benefit of society.

It would be a mistake, however, to completely ignore the social consequences of an economic activity even when we act as private individuals. What constitutes corporate social responsibility does not necessarily have to involve a positive contribution by the business to society; it may simply involve preventing a negative contribution.

For example, smoking is a harmful habit that has negative consequences for consumers' health and burdens the healthcare system. Although it generates substantial profit, a socially responsible

approach would be to restrict this activity and replace it with another activity which, although perhaps less profitable, would be preferable from the perspective of human well-being.

Another example could concern mass tourism. Tourism is an industry that generates enormous economic benefit, but the side effects of this profit often offset the benefit. We hear significant objections concerning tourism, and especially mass tourism, such as:

Environmental consequences: Pollution, overconsumption of natural resources, etc.

Social consequences: Overcrowding in popular destinations, increased cost of living and rents for permanent residents, pressure on public services (hospitals, transportation, water supply), and alteration of local identity and traditions when they are adapted exclusively to the needs of visitors.

Economic consequences: Dependence on tourism, which is vulnerable to economic cycles; seasonal employment and therefore unemployment; and the fact that a large portion of revenues may end up with large businesses rather than remaining within the local community.

At this point, it is also worth mentioning the destruction of the primary sector caused by tourism, either because land is used for tourism services, hotels, etc. rather than agricultural exploitation, or because human labor shifts toward tourism and abandons rural areas. Tourism is a more profitable activity and, from the individual's perspective, is therefore a preferable economic activity compared with the primary sector, which is an economic activity that benefits society but not the individual.

Cultural effects: Commercialization of cultural heritage; degradation of historical and cultural monuments due to excessive visitation; loss of the authenticity of local customs and traditions.

Effects on quality of life: Traffic congestion, noise pollution, etc., resulting in residents feeling that their area operates primarily to serve tourists.

Another characteristic example demonstrating the contrast between economic efficiency and effectiveness and human well-being concerns the very size of GDP. The growth of GDP by itself ignores products related to self-consumption or the informal economy and can therefore mislead us as an indicator.

Furthermore, as we mentioned, profitable activities such as smoking, mass tourism, war and the defense industry may generate substantial economic benefit, yet their harmful impact on society undoubtedly represents a decline in levels of human well-being.

GDP also ignores quality when quality is not reflected in price. In general, we have seen the tendency toward declining quality resulting from the attempt to maximize efficiency through the problem of “bad lemons” and the prisoner’s dilemma.

Finally, even at the purely economic level, one should focus on real GDP rather than nominal GDP, that is, on the creation of real wealth rather than income resulting from an increase in prices.

A goal of maximizing GDP may encourage irresponsible borrowing in an attempt to achieve these objectives. Therefore, an economic policy may appear successful in the short term, while in the long term it may harm the economy and the human lives affected by it—ultimately harming human well-being.

The economy requires a long-term perspective, yet people often think only in the short term when making economic decisions. This occurs very frequently with governments in democratic systems, which are primarily concerned with performance during their own four-year or eight-year term and disregard the longer-term consequences of the economic policy being implemented.

Therefore, a logic of maximizing efficiency may encourage irresponsible borrowing for electoral purposes, so that a government can consolidate and perpetuate its presence in a position of power.

We should also not forget that GDP per capita measures GDP per resident as a statistical quantity, and if an economy has significant inequality, this measure does not reflect actual well-being. Inequality tends, on the one hand, to increase GDP and therefore GDP per capita, but on the other hand, it makes this measure less meaningful, because it is simply a hypothetical number telling us what the income of each resident would be if everything were distributed equally, without taking inequality into account.

To conclude this section, I would like to combine the issue of the relationship between human well-being and efficiency with the first chapter and the schools of ethics we examined there.

The ethics embraced by a group of people, and therefore its social values, constitute the foundation upon which its economic and political system is constructed. If people are guided primarily by the consequences of their actions, that is, by the outcome, then the conditions for a capitalist system exist.

In capitalism, the objective is the achievement of profit, and this can also encourage morally inferior activities, such as smoking, which we mentioned, as well as films and television series that promote misguided social standards by displaying violence, crime, lust, etc.

A conscious and mature person does not desire happiness alone, but also wishes to be worthy of happiness, that is, to achieve this objective within the boundaries of morality.

If the pursuit of efficiency becomes the exclusive objective of our actions, then we may cross these moral boundaries if we are guided exclusively by the consequences of our actions.

Thus, even from the perspective of utilitarianism, utility for society as a unified whole may be negative when personal interest ignores the boundaries we have mentioned above.

Note that I am not necessarily claiming that personal interest should be subordinated to the public interest, unless by “public interest” we mean respect for the individual rights and freedoms of others.

The very definition of freedom given by a classical liberal and utilitarian such as John Stuart Mill constitutes, in itself, a strong limit on selfishness and self-interest, and this dimension is often not emphasized sufficiently. John Stuart Mill tells us:

> “The only freedom which deserves the name is that of pursuing our own good in our own way, so long as we do not attempt to deprive others of theirs, or impede their efforts to obtain it.”

An interesting critique of the relationship between ethics and economics, as well as of human well-being and the capitalist economic system, can be found in the work of John Ruskin, whose

thinking also influenced Mahatma Gandhi and led him to the conclusion that economics should serve human beings.

The main points of Ruskin's critique are as follows:

1. Money alone does not have value; what matters is whether wealth genuinely improves human life.
2. The market is not the most appropriate judge: it may reward activities that are socially harmful and undervalue useful forms of work.
3. Work must have dignity. He criticized industrial production because it turned workers into components of a machine, depriving them of creativity and meaning.
4. Ethics is above profit. Ruskin considered the exploitation and impoverishment of social classes to be not only morally reprehensible but also economically inefficient.
5. Criticism of competition as the sole organizing principle. He argued that cooperation and social responsibility are equally important for a healthy society.

11.2 Economics with an Embedded Ethical Logic

Economics is based on utilitarianism, at least insofar as it adopts the principle of maximizing benefit/utility. In contrast to utilitarianism, however, which focuses on maximizing the benefit of the whole, the dominant ideology in economic theory adopts methodological individualism and the principle of maximizing benefit at the individual level.

This is the principle of individualism, one of the fundamental principles of classical liberalism and the ideas that derive from it.

This can cause two kinds of problems:

1. When incentives are directed exclusively toward people's selfishness, they may encourage the formation of a society in which personal interest is placed above the public interest or the common good.
2. The maximization of benefit/utility may intensify human passions beyond the point that nature itself appears to intend.

Allow me to support my argument with a reference to moral philosophy and the schools we examined in the first chapter.

A leading figure of utilitarianism was Jeremy Bentham. Bentham adopts the principle of maximizing pleasure/happiness and eliminating pain/suffering, which also constitutes the essence of morality and, from this perspective, is a very good foundation for the science of economics.

However, Bentham himself was concerned about whether such a mentality might encourage the lower instincts and passions of human existence, such as physical pleasures, etc., which come at the cost of our health, etc.

The role of human passions should neither be overestimated nor underestimated. Voltaire, the Enlightenment philosopher, tells us:

> “Passions are like the wind for sailing ships; although they can drive us onto the rocks, we cannot move forward without them.”

Indeed, these concerns have a basis when we consider contemporary society and its shortcomings. We live in a society dominated by greed, lust, exploitation, etc. A society in which everything is sacrificed for money and profit: health, human relationships, etc.

My personal assessment is that philosophers/economists such as John Stuart Mill and Bentham were naturally advocates of freedom and individual dignity, while at the same time maintaining a better balance between the individual and society, between individual rights and social duties.

I base this, first, on the fact that utilitarianism as an idea focuses on the well-being of the majority of members of a group, while at the same time Mill tells us:

> “The only freedom which deserves the name is that of pursuing our own good in our own way, so long as we do not attempt to deprive others of theirs, or impede their efforts to obtain it.”

The development of a virtuous character is the key to achieving the above objective, and I believe that this is where the greatest emphasis should be placed by the educational system and by all institutions of the state.

This is what Adam Smith himself, the father of the science of economics, desired, as can be seen from his work as a professor of Moral Philosophy in Glasgow and from his first major work, *The Theory of Moral Sentiments*.

We will examine more about this in the next chapter.

In conclusion, I believe that an alternative form of economy or model should be developed that places greater emphasis on protecting the planet and the environment, as well as on animal welfare, since animals often suffer from human activity without any substantial reason.

Considerations such as those we mentioned regarding GDP are also of great value.

In their effort to maximize their profits and wealth, people ignore the consequences of their actions for those around them and for society.

Furthermore, activities that generate money are not always, or even necessarily, economically efficient. When an activity generates profit but does not encourage the creation of real productive wealth or a real product, it simply causes a redistribution of income in favor of some, while simultaneously reducing the overall GDP pie and therefore constituting irrational economic behavior from the perspective of society as a whole.

For example, smoking, the defense industry, advertising, television, etc. are such cases.

We often hear people around us complain about rising prices of food products, but we never hear anyone complain about the cost of a video game, a film, a mobile phone, a concert, etc.

This means that financial resources should be directed more toward the primary and secondary sectors, toward the production of goods necessary to meet basic survival needs rather than merely satisfying social desires.

When all financial resources flow into the entertainment industry, for example, it is natural that, as a society, we may be deprived of more essential goods, which are sacrificed in order to produce other goods.

To put it scientifically, we produce goods with a higher opportunity cost than other goods that we could produce. At the same time, when resources flow in the wrong direction, we have an increase in supply and a fall in prices for goods of lesser importance, whereas we should have a corresponding increase in the supply of essential goods: housing, clothing, food, etc.

Can the state do anything about this?

There could be protectionist measures, such as imposing consumption taxes to discourage consumption, or tariffs and quotas. However, these measures would prove inadequate without genuine consumer education.

In addition to consumer education, there should also be restrictions on economic activities that are demonstrably harmful to the ecosystem, the environment or any third party, and state intervention is necessary in this respect.

Consumer education is the set of knowledge, skills and attitudes that help individuals function as informed, responsible and critical consumers.

Its objective is to enable them to make sound decisions concerning the purchase and use of goods and services while also knowing their rights and obligations.

Some of the objectives of consumer education are:

- Developing critical thinking toward advertising and commercial practices.
- Proper management of financial resources.
- Protecting health and safety through sound consumer choices.
- Promoting sustainable and responsible consumption with respect for the environment and society.

In practice, consumer education includes, for example, the ability to:

- compare prices and product quality;
- read labels and terms of purchase;
- recognize misleading advertisements;
- know when one is entitled to a refund or replacement of a product;
- make safe purchases, particularly online.

In short, consumer education is the education that helps individuals make conscious, responsible and safe consumer choices, protecting their interests and contributing to the proper functioning of the market and society.

---

273. See Chapter 5.

274. Vaxevanidou, Maria and Rekleitis, Panagiotis, *Principles of Business Organization and Management*, 3rd EPAL. “Diofantos” Publications, 2015.

275. See Chapter 2, p. 74.

276. See p. 139.

277. See p. 140.

278. John Stuart Mill, *On Liberty* (1859), Chapter I, “Introductory,” author's own translation.

279. See Elton Mayo, F. Roethlisberger and the Human Relations Movement.

280. The phrase is attributed to Voltaire, although it has not been confirmed that it is genuinely his own quotation.

281. The phrase is authentic and comes from John Stuart Mill's work *On Liberty* (1859).

CHAPTER 12 — ECONOMISTS AND RESPONSIBILITY: THE ETHICS OF THE PROFESSION

12.1 The Influence of Economics on Society

"Ideas shape the world."

— **John Maynard Keynes**

This chapter perhaps constitutes the essence of this work and leads to the fundamental conclusion that I wish to reach. It combines elements from several preceding chapters, such as the role of the state, the incompatibility between Adam Smith's two works, and the distinction between positive and normative economics.

In Chapter 2, we examined the basic principles, axioms, and methodological tools used in economics. These tools are based on the ethics of **utilitarianism** as well as on **methodological individualism**. This means that, just as utilitarianism adopts the principle of maximizing benefit for society as a whole or for the majority of its members, modern economics adopts the same principle at the level of the individual.

However, a mistaken interpretation of this methodology can have unpleasant side effects for society.

In the same chapter, we made a distinction between **normative and positive economics**, so I will not discuss their differences in detail here and instead refer the reader back to Chapter 2 to recall these concepts.

What I wish to argue is that a disproportionately strong or exclusive emphasis on positive economics—or on a normative economics that adopts its basic axioms as categorical moral imperatives, such as **neoliberalism**—can result in the formation of a society that may often confuse an economic rule with a rule of proper moral conduct.

In the Prologue, I referred to a principle from the philosophy of **David Hume**, the so-called **"is–ought" fallacy**.

What is this?

In simple terms, Hume tells us that we cannot infer what we **ought** to do solely from how things **are**. He observed that many people begin by describing facts—what is happening—and suddenly arrive at a moral conclusion—what ought to be done—without explaining the transition between the two.

It should be noted that Hume dealt with economic questions and had a major influence on **Adam Smith**. Smith's two apparently contradictory works could be viewed as an account of the **"is"** (*The Wealth of Nations*) and the **"ought"** (*The Theory of Moral Sentiments*).

Adam Smith's attempt to bridge this gap constitutes a remarkable contribution.

Another similarly interesting contribution is the scientific research carried out by the so-called **Public Choice School** and the **New Political Economy**.

Here we can identify figures such as **James Buchanan, Gordon Tullock, Mancur Olson, and Anthony Downs**.

The **Public Choice School** is a theoretical approach in economics that applies the principles of economic analysis to the political process, namely methodological individualism, the principle of maximizing benefits, and minimizing costs.[279]

According to this school, the state does not always seek to fulfill its duties or pursue a “public interest.” Instead, it promotes the personal interests of the people who constitute it.

For example:

- Politicians primarily seek to be re-elected.
- Public officials seek larger budgets, greater power, or better remuneration.
- Voters vote according to their personal interests.
- Interest groups—unions, professional associations, businesses, and others—exert pressure in order to obtain privileges.

Their works are particularly interesting, but I would like to focus especially on two of them:

1. **The Calculus of Consent** by Buchanan and Tullock.
2. **An Economic Theory of Democracy** by Anthony Downs.

After reading these works, one could easily conclude, although incorrectly, that the above-mentioned authors advocate the idea that individual selfishness is a positive characteristic.

Their intention, however, is not this.

They do not tell us that it is good for someone to be selfish. They simply argue that if a theory does not take individual self-interest into account as part of its methodological foundation, then that theory cannot function practically in real life.

The **Public Choice School**, or the theory of rational choice, therefore constitutes yet another serious attempt to bridge the gap created by **Hume's Guillotine**.[280]

This side effect of economic theory, neoliberalism, and other liberal ideologies has an unfavorable influence on society, because many people misunderstand or misinterpret them as theories that elevate personal interest into a **moral rule and imperative of proper conduct**.

This is not the case if one studies carefully both of Smith's works as well as the writings of the New Political Economy.

Unfortunately, this influence is very negative and constitutes one reason for the hostility or aversion of socialists and left-wing thinkers toward free-market ideologies and, potentially, toward economics itself as a science.

However, the solution to the problem we are seeking cannot be based on an unrealistic foundation such as **altruism and selflessness**.

The unacceptable inequality that we observe around us is a consequence of this mistaken worldview.

In Chapter 6, we examined the harmful effects of an excessive commitment to profit and the side effects this has on society.

These effects include the widening of inequalities and therefore an increase in poverty, both at the individual level and at the level of national economies, where countries such as the United States consume 20% of global wealth, meaning that other countries remain in conditions of absolute poverty.

This conclusion is understandable if we take into account the problem of scarcity of the factors of production and therefore the scarcity of the economic goods that can be produced from them.

We should also not forget that many principles of economics are based on societies belonging to other historical periods, such as the eighteenth century, the era in which the great Scottish philosopher and economist **Adam Smith** wrote.

During those periods:

- there was no television;
- there were no social media;
- there was not the level of overpopulation that exists today;
- and technology was at a completely different stage of development.

Today may therefore be the time to reconsider certain conclusions that belong to another historical era.

If one reads *The Wealth of Nations*, one will find references to markets for food, industrial products, and other goods of significant utility—goods that satisfy important human needs.[281]

With the development and multiplication of human needs, capitalism today has led to a distortion of society.

However, this is not the only negative effect of economics, as we shall see in the next section.

12.2 When Does an Economist Have an Ethical Responsibility for His or Her Forecasts?

A related issue concerning the influence of economics is the ability of economists and economic science to forecast the development of various economic variables, whether these concern financial securities, macroeconomic variables, or investment returns.

One should not make the mistake of assuming that a forecast concerning the above variables is always 100% accurate, since it is based on the processing of historical statistical data, and there is no absolute certainty that historical patterns will be repeated. Experience does, of course, show that both the economy and the market tend to follow particular cycles and trends that recur in symmetrical patterns. However, even this can conflict with the forecasts of an economist because the forecast may be based on a different technique or methodology. I am referring here to the distinction between **fundamental analysis and technical analysis** when forecasting the movement of prices of financial variables, such as currencies, stocks, bonds, and so forth.

This uncertainty is more pronounced in financial-market products. However, a similar uncertainty can also be found in the behavior of macroeconomic variables concerning:

- GDP;
- unemployment;
- the propensity to save or consume;
- inflation;
- and so forth.

It is less pronounced in these areas because they are less affected by social and psychological factors than the stock market.

Nevertheless, they are also unpredictable because there are factors that economics does not take into account.

In economics, we make certain assumptions, such as the assumption that people are **rational** and seek to maximize their benefit regardless of the position in which they find themselves.

For example, the rational consumer seeks, given a particular income, to maximize the utility they obtain at the lowest possible cost. To achieve this, they compare prices and make a rational choice. [282]

As a producer, the individual seeks to maximize profit.

As a worker, they seek to secure employment with the best possible remuneration and working conditions.

As an employer, they seek an efficient employee who will produce the maximum possible amount of labor per euro of cost.

We can understand that in order for the idea of an ideal market—**perfect competition**—to function, it is necessary for every side to have complete knowledge of the relevant information and full access to information.

This ensures that a balance of forces can emerge in a market in which interests come into conflict. [283]

This is another assumption made in economics.

However, these assumptions may be unrealistic and may not correspond to reality.

Why does this happen?

Economic science, and particularly **positive economics**, is based on the same methodology used by the natural sciences to describe and analyze economic phenomena.

Adam Smith was fascinated from the beginning by the methodology of **Isaac Newton** and attempted to adopt the same logic in economics.

An interesting analysis of this issue can be found in the work of **Karl Popper**.

More specifically, Popper developed a criterion for distinguishing between a scientific and a pseudoscientific theory, and there are not a few people who argue that economics is not essentially a science.

Personally, I would not agree with this view. Economics is simply a **social science**, rather than a purely positive or natural science, and the same methodology cannot be completely compatible with it. It is a science that resembles political theory, sociology, and philosophy more closely.

Nevertheless, despite its shortcomings, this methodology is necessary for understanding social phenomena.

The assumptions of economics constitute a necessary simplification and abstraction from complex reality.

Without making such generalizations, we would not be able to draw any conclusions, and this would increase the risks faced by economic actors.

However, economics should also pay attention to the criticism directed against it and should not apply the methodology of the natural sciences in such an absolute manner.

Economists, such as Adam Smith, adopted this methodology with the intention of giving economics a certain degree of prestige—a prestige comparable to that of the natural sciences.[284]

The final results, however, are not equally certain as those of the natural sciences.

This is the main point that should change.

Such analyses should not be presented by official institutions as something absolutely certain or inevitable, because non-specialists may be misled and, quite reasonably, may feel disappointed and deceived.

The ultimate consequence is that economics itself loses credibility and people turn their backs on economics in general.

Physics, however, is governed by immutable laws that do not deviate from reality.

In economics, by contrast, a law may not have practical application in all circumstances because it is based on unrealistic assumptions.

For example, not all entrepreneurs seek only to maximize profit.

They are often also guided by social objectives, as we saw in previous sections.

Profit is not only money; it can also be the satisfaction that someone derives from making a social contribution.

Another reason why these assumptions may be unrealistic is that society and the economy contain **thinking agents** who do not always behave rationally and who act according to what they themselves perceive to be in their interests.

For example, a policy intended to subsidize production may ultimately become a policy that subsidizes consumption because individuals may judge that this maximizes their profit over a shorter period of time.

When a free market does not contain a mechanism that ensures the proper allocation of resources, the final result will also diverge from the expected outcome.

With regard to the evaluation of investments, the same methodology is applied.

However, investments are usually analyzed under different scenarios, with each scenario based on particular assumptions concerning the firm's broader external environment and conditions that are not under the firm's control, such as:

- interest rates;
- fiscal policy;
- inflation caused by external factors;
- and so forth.

This uncertainty and indeterminacy are even more pronounced specifically in **stock-market investments**.

The prices of all economic variables are influenced by social and psychological factors, but this influence is particularly strong in the stock market.[285]

For example, bad news may frighten depositors and lead to a mass withdrawal of deposits from banks, thereby threatening the stability of the banking system.

It may also restrict consumption and the functioning of the economy. It is even more likely, however, to cause destructive free-falling or bubble-like upward trends in stock and bond markets, where speculation based on price differences is the primary motivation for transactions.

A particularly interesting approach to this problem is the **theory of reflexivity** developed by the well-known philanthropist and businessman **George Soros** in many of his works and lectures.

George Soros's theory of **reflexivity** argues that in financial markets—and in many social situations—people's perceptions do not merely reflect reality; they also contribute to shaping it.

The basic idea is that there is a cycle of interaction:

1. People form beliefs about what is going to happen.
2. Based on these beliefs, they act—buying, selling, investing, and so forth.
3. Their actions change reality itself.
4. The new reality influences their beliefs once again.

This creates a **feedback loop**.[286]

Example

Imagine that many investors believe that property prices will continue to rise.

- They buy more property.
- Increased demand actually raises prices.
- Banks, seeing the higher prices, provide more mortgage loans.
- This increases demand and prices even further.

The original belief therefore becomes, at least temporarily, **self-reinforcing**.

At some point, however, prices may move so far away from their fundamental values that the cycle reverses, leading to a sharp decline.

Often, the fundamental variables themselves are also affected by the bubble and therefore do not constitute a reliable criterion of safety when assessing the risks associated with business or investment decisions.

---

[279] See Chapter 2.

[280] Another name for the **is–ought problem** or **is–ought gap** discussed earlier. It is called “Hume's Guillotine” because Hume “cuts” the logical connection between propositions that describe reality (“is”) and propositions that express moral obligations (“ought”).

[281] The **hierarchy of needs proposed by Abraham Maslow** provides one way of understanding the importance of human needs.

[282] Marginal utility per euro (or another monetary unit) is a numerical measure that serves this purpose.

[283] The producer seeks to sell at a high price, whereas the consumer seeks to buy at a low price. The entrepreneur seeks to reduce labor costs and increase the working time of employees, whereas the employee seeks a higher wage as well as fewer working hours.

[284] Varoufakis, Y. (Ed.) (2007). *Political Economy: Economic Theory in the Light of Criticism*. Edited by Yanis Varoufakis and Manos Kountouris. Athens: Gutenberg.

[285] See Section 3.3 on behavioral finance, etc.

[286] Soros, G. (1999). *The Crisis of Global Capitalism: The Open Society Endangered*. Translated by Ariadni Alavanou. “Nea Synora” Livani Publishing Organization, Athens, 1999. The original work was published in 1998.

Chapter 13 — Conclusion: A New Ethics for a New Economic World

13.1 Summary of the Main Conclusions

As we complete this work, we should briefly summarize what we discussed in each chapter, as well as some conclusions that can be drawn. The structure of this work consists of 14 chapters; let us look specifically at the positions that were formulated and the conclusions that can be reached.

Chapter 1 — Moral Philosophy and the Major Schools of Thought

Ethics is a branch of philosophy that has a particular role in political economy and, more specifically, in normative economic theory. In the first chapter, we examined the schools of ethics, some of the connections between them, and their effectiveness with regard to economic decisions. What we could conclude is that the various schools of ethics are not necessarily substitutes for, or competitors with, one another, but could perhaps be regarded as complementary, insofar as they pursue the same result in different ways.

The School of Virtue, first of all, places emphasis on good and virtuous character rather than on specific behaviors and rules. If a character is not genuinely virtuous, then he or she will not be able to faithfully follow the rules; it will instead appear as a kind of theatrical adaptation of vicious people to a virtuous framework.

Utilitarianism focuses on the forces of pain and pleasure, which are the dominant forces of our nature and, given that they determine our behavior, if our morality is not based upon them, it will not be able to reach our ultimate objective: virtue.

Deontology and Kantian ethics are based on standardized rules of conduct intended to promote virtue. However, they do not guarantee this by themselves, since individuals can adapt to this legal framework even without possessing virtuous character. We also mentioned that excessive legislation in a state governed by the rule of law often obstructs free economic activity.

We placed particular emphasis on the ethics of Hume and Smith during the period known as the Scottish Enlightenment. Adam Smith and David Hume base their ethical theory on sentiment and human passions rather than on Kantian reason. This is therefore another interesting approach containing elements of realism, since emotion and passions are inseparable parts of human existence and their forces always prevail over reason.

Emotion is the basis of morality according to Hume. This conclusion should not surprise us, since empathy is what makes us moral and social beings. Empathy connects our self-love with our love for others. It is what makes the pain or happiness of others become part of our own happiness or suffering.

There is a connection between Adam Smith's ethical theory, Kantian ethics and the School of Virtue, and this is the essence of this work and what it seeks to emphasize. One of my central positions is that Adam Smith is misunderstood when we treat his two works separately rather than as a unified whole.

The free market serves as a means of promoting the ethical theory expressed in *The Theory of Moral Sentiments*. A very useful concept for achieving this is what is known as market discipline. We will return to this later.

Chapter 2 — What Is Economics? Constraints, Models and Values

Here we discussed the basic principles and axioms of economics, distinguished between normative and positive economics, and examined how the principle of *homo economicus* should be understood.

The idea of *homo economicus* was first referred to by John Stuart Mill, who, as a utilitarian, believed in the welfare of the majority and not in the interests of a minority that could benefit from the exploitation and suffering of the many. This alone demonstrates the ethical limits of *homo economicus*.

Finally, Mill's own definition shows us the golden mean between personal freedom and our duty toward others and society. He tells us that everyone may pursue his or her own happiness, provided that they do not prevent others from doing the same.

For a supporter of socialism, this principle could be regarded as an idea promoting extreme individualism or self-interest. For a liberal, it could perhaps be interpreted as a principle establishing the boundaries between the “I” and the “we” and showing the balance between them.

Regardless of how one interprets it, these prejudices are subjective opinions, whereas objective truth is one. Personally, I consider this idea to constitute a very strong limitation on selfishness, and I do not believe it would be correct to associate the idea of the free market or liberalism in general exclusively with selfish interest.

Rather, it legitimizes personal dignity and the development of the self, which is also part of our nature, through conventional means and/or promotes sociability, not through state intervention, but under conditions of freedom through education and the cultivation of virtuous character.

PART B — Ethics “Within” Markets

Chapter 3 — Ethical Incentives in Economic Behavior and Chapter 4 — Ethics and Market Failures

In this chapter we show that the free market provides ethical incentives. The very idea of natural liberty and the natural price is an idea that defines value in a fair manner.

This idea was initially formulated by the French Physiocrats (Turgot, Quesnay, etc.) and subsequently spread by Adam Smith and the economic theory he formulated in his second major scientific work, *The Wealth of Nations*.

Here one could also identify an alignment of views between the European (French) and British (Scottish) Enlightenments. The market does not aim to promote individual interests, but to balance them.

When the market is perfect, that is, when it operates without imperfections and there is proper competition, a balance of forces is ensured, which acts as the guarantor of justice and dignity. By

contrast, a society and economy that bases its morality and justice on interventionism, coercion and fear of the law will inevitably fail to achieve the desired result.

Finally, in the same chapter we discussed profit and the side effects it has on society. An insatiable thirst for profit generates exploitation but also promotes economic activities that do not offer anything genuinely meaningful.

Meeting lower and insignificant needs is more profitable than meeting more important and essential survival needs. I will refer the reader to a critique in the tradition of Noam Chomsky and John Ruskin, as well as to the Institute for New Economic Thinking, for a more comprehensive analysis of this issue.

If we consider John Ruskin or the criticism made even by liberals themselves, such as Adam Smith, Bentham and Mill, we will see that problems with the free market and capitalism existed even during the periods when it operated effectively.

This is even more evident today, when the development of social media, television, etc. and the excessive exposure and advertising have magnified human passions and strengthened economic activities that do more harm than good, particularly if we take into account the scarcity of resources and what we sacrifice for what we gain.

What we gain immediately can be seen, perceived and felt. What we sacrifice, however, is nowhere visible, and this can mislead us.

PART C — Political Economy & Moral Justice

Chapter 6 — Justice in the Distribution of Resources

In this chapter we initially examined the subject matter of political economy, which consists of three basic questions concerning the satisfaction of human needs through the production of economic goods, together with a fourth question relating to the long-term development of the economy.

One of these fundamental questions concerns the distribution of resources, that is, for whom wealth is ultimately produced.

Theoretically, equality is an ideal, a goal. However, absolute equality could be socially harmful if it is unjust and distorts incentives for genuinely productive work.

The idea that appears to me to be the most realistically sustainable is the one formulated by John Rawls in *A Theory of Justice*, as well as by other theorists belonging to so-called social liberalism, such as John Stuart Mill and John Maynard Keynes.

I will not analyze these ideas again, since this has already been done in the main body of the work. What I would like to mention is that identifying with the ideology of social liberalism should not lead us to reject other ideas, such as classical liberalism or even social Darwinists such as Herbert Spencer.

Social liberalism, as an idea, combines elements from both socialism and classical liberalism. Both Rawls and Robert Nozick, who was regarded as his ideological opponent in the debates of their time, are successors to the tradition of the great German philosopher Immanuel Kant.

In the following Chapters 7 and 8, I formulate my positions regarding the proper role of the state and how this objective can be achieved.

The basic idea I want to convey to the reader is that it is absolutely necessary to have limits on the distribution of income: both lower limits, below which the state should not allow income to fall—something that guarantees the basic human and constitutional rights of all people to food, shelter, security and dignity—and upper limits, since excessive wealth has very negative consequences, which we examined in the main part and will not analyze again here.

Indicatively, we can say that the very balance of the market becomes distorted, since fair prices capable of bringing such dissimilar incomes into equilibrium cannot exist. In addition, inequality generates poverty and even inflation and has adverse social consequences, such as class discrimination, etc.

The section concerning taxation in this chapter is particularly important. We often fail to see our own mistakes and tend to blame politicians for everything. It is our own tax evasion or legal avoidance of our obligation toward society that is the cause of the problems.

For this reason, the cultivation of virtuous character is more important than strict standardization and discipline through the enforcement of positive laws.

Chapter 9 — The Economics of Inequality: Ethical Implications

In this chapter we remained within the same area concerning the proper distribution of resources and presented the same arguments and positions, enriched with arguments demonstrating through statistical research that the size of income does not add to human well-being beyond a certain point.

There are other things a person needs in order to be happy after that point, rather than additional money: good health, a clear conscience, education, creativity, etc.

In this chapter, combining the weaknesses we identified in taxation—including income taxation, expenditure taxes, property taxes, consumption taxes, etc.—I propose a new system of redistribution which, in my opinion, would be more compatible with the free market, since it would not require additional state intervention and would occur spontaneously through voluntary transactions taking place within a free market.

My idea is to establish a system similar to that of floating exchange rates used in international trade to achieve balance of payments.

A similar balance should also exist in individual incomes, in order to balance individual demand curves, rather than the market-wide demand curve, with supply.

The market constitutes a whole, and an ideology that claims to place the individual as its fundamental priority cannot focus on the equilibrium of a generalized market and not on each member of that market, or at least on smaller, homogeneous groups or categories of the population.

Chapter 10 — Technology, Artificial Intelligence and New Ethical Risks

In Chapter 10 and its constituent sections, we referred to technology, something that I consider very important and should not omit.

In my view, technology should be utilized and should not be treated as a threat to human independence. Many people see technological development as a threat that will make many professions unnecessary and thus cause people to lose their independence, since they will no longer have their own income and will depend exclusively on the state and whatever subsidies it may provide.

In order to make proper use of technology, we should examine both its advantages and disadvantages. We cannot fail to mention the advantages: lower production costs and falling prices, meaning that goods become accessible to more categories of the population.

Communication and transportation have been facilitated, and we have now entered the information age, in which information is available in a way that improves the system and ensures a balance of forces within society.

The fact that unemployment may increase if human labor is reduced and replaced by modern technology and automation should not be regarded as something negative that deprives people of their independence and therefore their freedom. On the contrary, it can be viewed as a prospect that liberates us from the bonds of human labor.

In such a case, the need for state protection of the weakest or lowest-income groups becomes even more pressing and reinforces the positions formulated in this work.

In Chapter 3 we examined a relationship between religion and economics. For Protestants, work is something sacred, and the industrious person is accepted by God, whereas idleness is not accepted in God's eyes.

Work, however, is essentially a necessary evil rather than a blessing from God. Although Christianity praises work as something positive and socially worthy of approval and admiration, in the Old Testament we read that work, while initially part of God's plan for Adam and Eve:

> “And the LORD God took the man, and put him into the garden of Eden to dress it and to keep it.”
> *(Genesis 2:15)*

Later it becomes associated with toil and pain and becomes the punishment of humanity for its betrayal and disobedience to God's will:

> “In the sweat of thy face shalt thou eat bread...”
> *(Genesis 3:19)*

Therefore, a prospect that could free us from this punishment, from this necessary evil, should not be viewed with suspicion or as a threat to humanity. It could constitute an earthly paradise, like the one Jesus promised in the Kingdom of Heaven.

This prospect is supported not only by advocates of the free market but even by followers of Karl Marx himself. In *The German Ideology*, he writes specifically:

> “To hunt in the morning, fish in the afternoon, rear cattle in the evening, criticize after dinner, without ever becoming hunter, fisherman, herdsman or critic.”

He does not describe a program for the ideal society, but uses the example to demonstrate that people would not be trapped in a single professional identity. Marx did not imagine that people would stop working. He believed that work would become free and creative.

Technology also carries risks, however. The proper use of technology should be part of consumer education. Technology, for example through social media, should make us more social rather than becoming a nest for fraudsters.

It should also promote healthy consumption through greater access to information rather than the destruction of natural resources and extreme inequality.

At this point I should recall the words of Jean-Jacques Rousseau, that civilization and technology destroy human beings. He even coined the term “noble savage” to demonstrate the contrast between what modern human beings appear to be and what they actually are, compared with the uncivilized person of a primitive society.

PART D — Toward a More Ethical Economic Practice

Chapter 11 — An Alternative Approach to Markets

This chapter draws elements from Chapter 5 and the relationship between profit and society.

Often, in the pursuit of profit or money, other things are sacrificed that ultimately have greater value than we initially thought.

Economic activities that generate profit and money for the individual are often socially harmful, and from the individual's perspective it is not always easy to understand the ways in which these socially harmful activities can ultimately turn against and harm the individual as well.

When an activity, such as drugs, increases crime, it is only a matter of time before this affects us at the individual level as well. If an activity encourages war, then war will eventually reach our own doorstep.

But even milder activities, such as tourism, can become socially harmful when they exceed acceptable limits.

The additional money comes at the cost of sacrificing the primary sector, altering cultural heritage, and ultimately generating high inflation through rising property prices and the contraction of the primary sector that we mentioned.

Chapter 12 — Economists and Responsibility: The Ethics of the Profession

In this chapter we conduct a basic analysis and arrive at fundamental conclusions from the argument developed in previous sections, based on ideas such as the incompatibility of Adam Smith's two apparently opposing works, Hume's Guillotine, etc.

Hume's Guillotine refers to the problem that arises in various social sciences, including economics, and concerns the transition from “is” to “ought.”

Theoretical scientists refer to the tendency of people to show preference for themselves, to primarily serve their own selfish interests, to be consequentialists by nature, etc., and then proceed

to formulate categorical imperatives without adequately explaining how this transition can take place on the basis of spontaneous human nature.

Economics should not fall into this trap of confusing the “is” with the “ought.”

In the same chapter, in the following section, we also discuss the predictions that arise from economic science, since these too constitute a source of dissatisfaction and a sense of deception for some people.

Economics is treated as a positive science and adopts a methodology similar to that of the natural sciences, which seems to be intended more to lend it a certain degree of prestige than to be fully compatible with it as a methodology.

However, this does not mean that this methodology should be abandoned. Rather, its conclusions should simply not be presented as being as strong and immutable as the laws of physics.

Economics is a science, but it is a social science, not a positive or natural science. It is similar to sociology, philosophy or political science. Nevertheless, the contribution of positive economics is valuable and should not be underestimated.

Chapter 13 — Conclusion: A New Ethics for a New Economic World

This is the point at which you have arrived in reading this work.

Here we briefly bring together some of the basic positions and arguments that have been developed throughout this book. For a more detailed analysis, the reader should refer to the main body of the work.

In closing, I would like to mention some of the fundamental values in which we believe within our civilization and which shape our culture, as well as values embraced by other societies that we should adopt and adapt to our own culture, together with the way in which this should be done.

This is what I attempt to do in the next section, which is also the final section, and in this way I conclude the present work by demonstrating perhaps how important faith in a code of values is and how important I consider it to be that these ideas prevail in the proper manner.

13.2 Final Positions on How Values Should Be Integrated into Markets and Political Economy

First, what do we mean when we speak of “values”? Social values are ideas or ideals to which we attach value or consider important: Freedom, Security, Discipline, Justice, Equality, Humanism, Equality before the Law, etc. These values may differ from society to society or often even within the same society from one period to another. For example, in Greece in 1950, security or justice appears to have carried greater weight than today, when values such as Freedom have acquired particular importance.

A balance and an appropriate mixture of all these ideals would be ideal.

Our society, as part of a global capitalist empire, is based on the value of freedom and, more specifically, economic freedom, where freedom of transaction and the movement of capital are considered fundamental rights capable of bringing about the desired market equilibrium, provided that appropriate information is available to every side of the transaction.

Otherwise, what economics calls “moral hazard” may arise, which is a case belonging to the broader category of problems involving “asymmetric information.”

If the transaction is genuinely free and there is no compulsory transfer of money or payment, then exploitation cannot occur because the party being exploited would not voluntarily participate in the transaction.

I repeat that a necessary condition for this is access to knowledge and adequate information.

Furthermore, if the transaction is free, without protection through state measures, moral hazard is also reduced because the parties have an incentive to behave more responsibly.

For example, a bank is more careful in managing deposits, which are other people's money, if it knows that citizens are not obliged to bail it out in the event of bankruptcy.

Indeed, freedom is a very important value. However, if we deify it and forget the other values, freedom is transformed into license and irresponsibility.

There can be no freedom without moral rules, and therefore without justice, security, humanism, etc.; that is, freedom cannot be detached from the other values we have mentioned.

What produces profit or pleasure at the personal level often comes into conflict with the interests of others or of society. When this occurs, it is necessary to have rules and ethical limits that ensure that the public interest remains dominant and takes priority over private interests.

The state grants freedom to individuals and to the market, not in order to surrender its sovereignty, but in order to improve the efficiency of the economy.

States remain sovereign, and legislation that limits their sovereignty for the benefit of the individual is mistaken and should be revised where this occurs, particularly in cases concerning private entrepreneurs, industrialists, etc. belonging to the bourgeois class.

The idea of *laissez-faire* was developed by the French Physiocrats and later by the Scottish philosopher and economist Adam Smith.

The French Physiocratic economists placed great emphasis and priority on the primary sector of production, particularly agriculture, while Adam Smith accepted the labor theory of value, as did Karl Marx. Today, this idea is more commonly heard in connection with the liberalization of multinational corporations, the privatization of state infrastructure and organizations, and banks. *Laissez-faire* is now more closely associated with Wall Street or the City of London.

As for unlimited freedom, a popular view is often mistaken, and success in the market does not guarantee that something actually possesses genuine value.

Let us recall again how Adam Smith himself defines value.

Therefore, intervention in the market in order to promote ideas, values or products that the market itself does not voluntarily choose may be socially necessary and valuable as an idea.

After all, even the very idea of the free market requires certain public goods and a state that will provide security, justice, national defense, etc.

Example: If the market prefers television programs or romantic novels to a book by Plato or Aristotle, does this mean that these romantic novels or television programs have greater value than Plato or Aristotle?

The objective, however, is for this maturity and rationality to occur spontaneously and not through state coercion.

Discipline is just as important as freedom, but it should originate within us rather than come to us from outside.

State coercion is not appropriate for modern human beings, who ought to be capable of knowing good and evil for themselves and should not allow others to guide them according to their own interests.

Here a moral hazard arises, because when the state controls people's lives, there is no one who can guarantee that this will be for the benefit of the individual rather than for the benefit of power itself.

Even if a government or authority is good, in a democracy it will not be the only one, and no one can guarantee that the next governments will be equally capable and worthy.

This is another weakness of democracy and shows that a powerful authority elected through free elections may itself be problematic.

With regard to the non-economic sector, that is, matters concerning justice, the police, security and the state's role as an arbiter, I believe there is room for a stronger state presence, although state laws can often produce the opposite result from the one intended or ultimately prove ineffective.

If we observe, we will see that in regimes where the ideas of the philosophers we mentioned as representatives of the School of Virtue appear to have influence, there is a strong dominance and presence of the state, with strict rules that leave little room for individual freedoms.

This demonstrates that Virtue and Freedom often do not coincide when education is inadequate.

Education is the proper means by which human beings and society should proceed.

Therefore, the answer to the question of **how values should be integrated into markets is through education under conditions of freedom**, where **discipline will originate within us as a moral necessity**.

However, until humanity reaches this point, intervention and guidance by the state are necessary, especially concerning the non-economic sector in matters involving society or morality.

In the economic sphere, an intervention such as the one we examined in Chapter 6 and in Rawls's *A Theory of Justice* is particularly useful for maintaining the cohesion and balance of society.

Furthermore, depending on the circumstances and the stage of an economy, Keynesian economic policy may prove necessary for dealing with economic problems, depending on the particular phase in which the economy finds itself and the specific problem it is facing.

For example, in 1933 the Great Depression, which began in the United States and spread worldwide, resulted in the collapse of demand and caused high levels of unemployment.

An economic policy focusing primarily on the supply side could not address this problem, and thus the ideas of the British economist John Maynard Keynes gained influence.

The solution proposed by Keynes was expansionary economic policy, with public spending and government budget deficits, so that the state could replace the demand that the economy had lost as a result of the decline in private investment and consumption.

However, this excess eventually leads to another problem: high inflation and, gradually, rising prices, while the production costs of businesses also increase.

At this stage, monetarist economic policy appears to be the appropriate remedy for the economy.

From the 1970s onward, there was a shift from Keynes's theory toward the economic theory of Milton Friedman and the Chicago School.

In politics, these ideas were implemented by Margaret Thatcher and Ronald Reagan in Britain and the United States respectively.

State intervention in the market and the economy is not sustainable if an economy cannot achieve spontaneous equilibrium under conditions of free competition.

For example, if prices in the market are high, a legislated reduction in prices may create black-market phenomena, where products are sold at even higher prices with an additional markup.

For example, a legally imposed reduction in rents intended to reduce housing costs may have the opposite effect because it can restrict supply and make housing more difficult to find.

I would like to recall an example from recent economic history, specifically the speculative attack that took place against the British pound in 1992.

The British economy was experiencing a balance-of-payments deficit and could not maintain the fixed exchange rate of its currency as required by its obligations under the European Exchange Rate Mechanism.

Through intervention in the foreign-exchange market, the state attempted to maintain the exchange rate within the acceptable limits, but this proved impossible and the entire effort was futile.

Eventually, the pound was devalued, and only then was equilibrium restored.

This example demonstrates that if there is no spontaneous equilibrium under conditions of freedom, then the solution offered by state intervention is merely temporary and ultimately cannot be sustainable.

In closing, I would like to refer to Herbert Spencer and his work *The Principles of Ethics*.

Earlier we proposed a mixture of ethical state intervention and freedom, which may appear contradictory and incompatible.

Humanity, through individual responsibility, can adopt the ethical principles and discipline that society needs for its proper functioning and cohesion, by means of education rather than coercion.

This would be the ideal scenario in an ideal world, where people could live freely under a condition of anarchy.

In the real world, under realistic conditions, it is not possible—or, historically, not yet possible—for people to follow these ethical principles without an institution restricting them.

Therefore, if we look at the matter practically, humanity is not yet ready to take this step toward the complete liberation of the individual. The first historical step in this direction took place during the Enlightenment in the eighteenth century. However, perhaps we were not yet ready even for that first step. We should not make the mistake of rushing to take the next one, because this could lead to our downfall.

It is a goal toward which we ought to move. This position resembles what Herbert Spencer, in *The Principles of Ethics*, calls Absolute and Relative Ethics, thereby distinguishing between the ideal we ought to follow and what is actually feasible to implement in our everyday lives.

I refer the reader to this position in order to gain an understanding of the position proposed above.

---

294. Moral hazard is a situation in which an individual or organization takes on greater risk because they know that the cost of that risk will be borne by someone else, either entirely or partially. The word “moral” does not refer to morality in the philosophical sense (good or bad). It is used because protection against risk can create disincentives for responsible behavior; for example, an employee who knows that it is almost impossible for them to be dismissed may make less effort than if their performance were closely monitored.

295. When, in a transaction, the two parties do not possess equal knowledge, but one of them has additional information.

296. When a transaction is genuinely free and there is no compulsory transfer of money or payment, exploitation cannot occur because the party being exploited would not voluntarily participate in the transaction. The necessary condition is access to knowledge and adequate information.

297. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962).

298. Immanuel Kant, *Critique of Practical Reason*, trans. Mary Gregor (Cambridge: Cambridge University Press, 1997), 5:4–5.

299. Both Adam Weishaupt and Baruch Spinoza express the view that human beings should act from pure moral necessity and not from fear or coercion.

300. *Einige Originalschriften des Illuminatenordens* and the *Materialien*: “For Weishaupt, education constitutes the principal means of human liberation.” The internal writings of the Order repeatedly state that people must first be shaped educationally so that they become receptive to wisdom. A characteristic statement is: “We must first shape human beings... We must make them receptive to wisdom before we can teach them higher wisdom.”

301. Specifically, Spencer distinguishes between **Absolute Ethics** and **Relative Ethics**. Absolute Ethics refers to the ideal society, in which human beings have fully evolved and their interests are harmonized. Relative Ethics is the ethics we apply in real societies, where conflicts, injustices and imperfections still exist.

Bibliography

Greek-Language Bibliography

- Iliadis, N. & Voutsinos, G. (2022). *Technology — A' Vocational High School (EPAL).* "Diophantos" Publications.
- Varoufakis, Y. (Ed.) (2007). *Political Economy: Economic Theory in the Light of Criticism.* Edited by Yanis Varoufakis & Manos Kountouris. Athens: GUTENBERG.
- Drosos, D. (1994). *Market and State in Adam Smith: A Critique of the Retrospective Foundation of Neoliberalism.*
- Chomsky, N. (2002). *Profit and the Citizen: Neoliberalism and the Global Order.* Translated by Lambis Charalambidis. Kastaniotis Publications. (Original work published in 1999.)
- Papakonstantinou, K. & Katsiras, L. *Politics and Law — 2nd Grade of General Lyceum.* Ministry of National Education and Religious Affairs. Educational Book Publications, Athens.
- Aristotle. (1993). *Politics.* Translated by V. Moskovi. Athens: Kaktos Publications.
- Laos, N. (Ed.) (2010). *The Worldview of Freedom.* Edited by Zoe Ioannidou. Athens: Lexitypon.
- Mattick, P. (1978). *Marx and Keynes: The Limits of the Mixed Economy.* Translated by Vasilis Karalis. Odisseas Publications. (Original work published in 1969.)
- S. Drakopoulos & A. Karagiannis. (2003). *History of Economic Thought.* Kritiki Publications.
- Adam Smith. (2012). *The Theory of Moral Sentiments.* Translated and edited by Dionysis G. Drosos. Papazisis Publications, Athens, 2012. (Original work published in 1759.)
- Brown, W. (2017). *The Destruction of the Demos.* Translated by Soti Triantafyllou. Patakis Publications, Athens.
- Downs, A. (Ed.) (1997). *An Economic Theory of Democracy.* Edited by Ilias Katsoulis; translated by Thanasis Athanasiou & Niforos Stamatakis. Papazisis Publications, 1990. (Original work published in 1957.)
- Friedman, M. (Ed.) (2012). *Capitalism and Freedom.* Translated and edited by Giorgos Karabelas & Antonia Gounaropoulou. Papadopoulos Publications. (Original work published in 1962.)
- Kant, I. (1971). *Essays.* Introduction and translation by P. Evangelos Papanoutsos. Athens: Dodoni.
- Olson, M. (Ed.) (1991). *The Logic of Collective Action.* Translated and edited by Dionysis Gravaris & Ilias Katsoulis. Athens: Papazisis. (Original work published in 1965.)
- Heilbroner, R. (2000). *The Worldly Philosophers.* Translated by N. Ligris et al. Kritiki Publications.
- Thornton, P. (2017). *The Great Economists.* Translated by Soti Triantafyllou. Patakis Publications, March.
- Ferguson, Niall. (2011). *The Ascent of Money: A Financial History of the World.* Translated by Eftychia Pagoulatou. Alexandria Publications. (Original work published in 2008.)
- Soros, G. (1999). *The Crisis of Global Capitalism: The Open Society Endangered.* Translated by Ariadne Alavanou. "Nea Synora" — Livanis Publishing Organization. Athens, 1999. (Original work published in 1998.)
- Plato. *The Republic.* (1901). Translated by I. Gryparis. Athens: Zacharopoulos.

Foreign-Language Bibliography

- Mill, St. J. (1863). *Utilitarianism.* Published by *Fraser's Magazine*.
- Mill, J. S. (1848). *Principles of Political Economy, with Some of Their Applications to Social Philosophy.* London: John W. Parker.
- Spencer, H. (1862). *First Principles.* London: Williams and Norgate.
- Foucault, M. (1979). *The Birth of Biopolitics.* Published by St. Martin's Press.
- Hofstadter, R. (1944). *Social Darwinism in American Thought.* Published by the University of Pennsylvania.
- Kant, Immanuel. (1793). *Die Religion innerhalb der Grenzen der bloßen Vernunft.*
- Kant, Immanuel. (1785). *Grundlegung zur Metaphysik der Sitten.* Riga: Johann Friedrich Hartknoch.
- Popper, Karl R. (1945). *The Open Society and Its Enemies.* London: Routledge.
- Rawls, J. (1971). *A Theory of Justice.* Cambridge, MA: Harvard University Press.
- Smith, A. (1776). *An Inquiry into the Nature and Causes of the Wealth of Nations.* London: W. Strahan and T. Cadell.
- Marx, K. (1867). *Das Kapital: Kritik der politischen Ökonomie*, Vol. 1. Hamburg: Otto Meissner Verlag.
- Marx, K. & Engels, F. (1976). *The German Ideology.* In C. J. Arthur (Ed.), *The German Ideology.* London: Lawrence & Wishart.
- Hayek, F. A. (1960). *The Constitution of Liberty.* Chicago, IL: University of Chicago Press.
- Ruskin, John. (1862). *Unto This Last: Four Essays on the First Principles of Political Economy.* London: Smith, Elder & Co.
- Weber, Max. *The Protestant Ethic and the Spirit of Capitalism.* Translated by Talcott Parsons. London: Routledge, 1930.